FNCB Bancorp, Inc.
Form 10-K
March 08, 2019

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File No. 001-38408

FNCB BANCORP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Pennsylvania (State or Other Jurisdiction of Incorporation or Organization)	**23-2900790** (I.R.S. Employer Identification No.)
102 E. Drinker St., Dunmore, PA (Address of Principal Executive Offices)	**18512** (Zip Code)

Registrant’s telephone number, including area code **(570) 346-7667**

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

Common Stock $1.25 par value

(Title of Class)

Securities registered pursuant to Section 12(g) of the Act: **NONE**

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

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

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

Large Accelerated Filer	Accelerated Filer
Non-Accelerated Filer	Smaller reporting company
	Emerging growth company

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

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

The aggregate market value of the voting and non-voting common stock of the registrant, held by non-affiliates was $124,065,844 at June 30, 2018.

APPLICABLE ONLY TO CORPORATE REGISTRANTS

State the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: 20,108,561 shares of common stock as of March 8, 2019.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information required by Items 10, 11, 12, 13 and 14 is incorporated by reference into Part III hereof from portions of the Proxy Statement for the registrant's 2019 Annual Meeting of Shareholders.

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Cautionary Note Regarding Forward-Looking Statements.

This Annual Report on Form 10-K contains statements which are forward-looking statements within the meaning of Section 27A of the Securities Act, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements include statements relating to the outlook for which are subject to risks and uncertainties. These statements are based on assumptions and may describe future plans, strategies, financial conditions, results of operations and expectations of FNCB Bancorp, Inc. and its direct and indirect subsidiaries ("FNCB"). These forward-looking statements are generally identified by use of the words "may", "should", "will", "could", "believe," "expect," "intend," "anticipate," "estimate," "project", "plan", "future" or similar expressions. All statements in this other than statements of historical facts, are forward-looking statements.

These forward-looking statements are not guarantees of future performance and are subject to risks and uncertainties, some of which are beyond FNCB's control and ability to predict, that could cause actual results to differ materially from those expressed in the forward-looking statements. Important factors that could cause actual results of FNCB to differ materially from those in the forward-looking statements include, but are not limited to:

- weakness in the economic environment, in general, and within FNCB's market area could pose significant challenges for FNCB and could adversely affect FNCB's financial condition and results of operations;
- FNCB's concentrations of loans, including those to insiders and related parties, may create a greater risk of loan defaults and losses;
- FNCB's financial condition and results of operations would be adversely affected if the allowance for loan and lease losses is not sufficient to absorb actual losses or if increases to the allowance for loan and lease losses were required;
- if management concludes that the decline in value of any of FNCB's investment securities is other-than-temporary, FNCB is required to write down the security to reflect credit-related impairments through a charge to earnings;
- changes in interest rates could reduce income, cash flows and asset values;
- FNCB may not be able to retain or grow its core deposit base, which could adversely impact its funding costs;
- FNCB is subject to credit risk, which could adversely affect its profitability;
- FNCB's risk management framework may not be effective in mitigating risks or losses to it;
- FNCB is dependent on the use of data and modeling in both its management's decision-making generally and in meeting regulatory expectations in particular;
- FNCB's portfolio of loans to small and mid-sized community-based businesses may increase its credit risk;
- new lines of business, products, product enhancements or services may subject FNCB to additional risk;
- the appraisals and other valuation techniques FNCB uses in evaluating and monitoring loans secured by real property and other real estate owned may not accurately reflect the net value of the asset;
- FNCB depends on information technology and telecommunications systems of third parties, and any systems failures or interruptions could adversely affect its operations and financial condition;
- FNCB may be adversely affected by the soundness of other financial institutions;
- FNCB may face risks with respect to future expansion of acquisition activity;
- FNCB depends on the accuracy and completeness of information provided by customers and counterparties;
- FNCB could be subject to environmental risks and associated costs on its foreclosed real estate assets;

- FNCB may not be able to successfully compete with others for business;
- changes in either FNCB’s financial condition or in the general banking industry could result in a loss of depositor confidence;
- FNCB is a bank holding company and depend on dividends from its subsidiary, FNCB Bank, to operate;
- if FNCB loses access to wholesale funding sources, it may not be able to meet the cash flow requirements of its depositors, creditors, and borrowers, or have the operating cash needed to fund corporate expansion and other corporate activities;
- interruptions or security breaches of FNCB’s information systems could negatively affect its financial performance, financial condition or reputation;
- FNCB is subject to cybersecurity risks and security breaches and may incur increasing costs in an effort to minimize those risks and to respond to cyber incidents, and FNCB may experience harm to its reputation and liability exposure from security breaches;
- if FNCB’s information technology is unable to keep pace with growth or industry developments or if technological developments result in higher costs or less advantageous pricing, financial performance may suffer;
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- FNCB relies on management and other key personnel and the loss of any of them may adversely affect its operations;
- FNCB may be a defendant from time to time in a variety of litigation and other actions, which could have a material adverse effect on its financial condition, results of operations and cash flows;
- the requirements of being a public company may strain FNCB’s resources and divert management's attention;
- any deficiencies in FNCB’s financial reporting or internal controls could materially and adversely affect its business and the market price of FNCB’s common stock;
- FNCB’s disclosure controls and procedures and internal controls over financial reporting may not achieve their intended objectives;
- federal and state regulators periodically examine FNCB’s business and may require FNCB to remediate adverse examination findings or may take enforcement action against FNCB;
- FNCB may be required to act as a source of financial and managerial strength for FNCB Bank in times of stress;
- FNCB faces a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations;
- FNCB is subject to numerous “fair and responsible” banking laws designed to protect consumers, and failure to comply with these laws could lead to a wide variety of sanctions;
- FNCB is subject to laws regarding the privacy, information security and protection of personal information and any violation of these laws or another incident involving personal, confidential or proprietary information of individuals could damage FNCB’s reputation and otherwise adversely affect FNCB’s business;
- rulemaking changes implemented by the Consumer Financial Protection Bureau will result in higher regulatory and compliance costs that may adversely affect FNCB’s business;
- potential limitations on incentive compensation contained in proposed federal agency rulemaking may adversely affect FNCB’s ability to attract and retain its highest performing employees;
- FNCB Bank’s FDIC deposit insurance premiums and assessments may increase;
- new or changed legislation or regulation and regulatory initiatives could adversely affect FNCB through increased regulation and increased costs of doing business;
- changes in accounting standards could impact FNCB’s reported earnings;
- FNCB is subject to extensive government regulation, supervision and possible regulatory enforcement actions, which may subject FNCB to higher costs and lower shareholder returns;
- FNCB may need to raise additional capital in the future, but that capital may not be available when it is needed and on terms favorable to shareholders;
- damage to FNCB’s reputation could significantly harm its businesses, competitive position and prospects for growth;
- short sellers of FNCB’s stock may be manipulative and may drive down the market price of FNCB’s common stock; and
- other factors and risks described in Part II, Item 1A of this Annual Report on Form 10-K under the caption “Risk Factors.”

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. FNCB undertakes no obligation, other than as required by law, to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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PART I

Item 1. Business

Overview

The Company

FNCB Bancorp, Inc., formerly First National Community Bancorp, Inc., incorporated in 1997, is a Pennsylvania business corporation and a registered bank holding company headquartered in Dunmore, Pennsylvania. FNCB Bancorp, Inc. became an active bank holding company on July 1, 1998 when it acquired 100% ownership of the former First National Community Bank. In this report, the terms “FNCB,” "the Company," “we,” “us,” and “our” refer to FNCB Bancorp, Inc. and its subsidiaries, unless the context requires otherwise. In certain circumstances, however, FNCB Bancorp, Inc. uses the term “FNCB” to refer to itself.

Effective June 30, 2016, following receipt of required regulatory approvals from the Pennsylvania Department of Banking and Securities, First National Community Bank completed a charter conversion from a national bank to a Pennsylvania state bank. Following the change in charter, First National Community Bank changed its legal name to FNCB Bank (the “Bank”). Subsequently, on October 4, 2016, the holding company filed an amendment to its articles of incorporation to change its name from First National Community Bancorp, Inc. to FNCB Bancorp, Inc. The name change became effective October 17, 2016.

FNCB’s primary activity consists of owning and operating the Bank, which provides substantially all of FNCB’s earnings as a result of its banking services.

FNCB had net income of $13.3 million, $0.1 million, and $6.3 million in 2018, 2017 and 2016, respectively. Total assets were $1.238 billion at December 31, 2018, $1.162 billion at December 31, 2017 and $1.196 billion at December 31, 2016.

The Bank

Established as a national banking association in 1910, as of December 31, 2018 the Bank operated 16 full-service branch offices within its primary market area, Northeastern Pennsylvania, and a Limited Purpose Banking Office (“LPO”) based in Allentown, Lehigh County, Pennsylvania.

Products and Services

Retail Banking

The Bank provides a wide variety of traditional banking products and services to individuals and businesses, including online, mobile and telephone banking, debit cards, check imaging and electronic statements. Deposit products include various checking, savings and certificate of deposit products, as well as a line of preferred products for higher-balance customers. The Bank is a member of the Promontory Interfinancial Network and participates in their Certificate of Deposit Account Registry (“CDARs”) and Insured Cash Sweep (“ICS”) programs, which provides customers with ability to secure Federal Deposit Insurance Corporation (“FDIC”) insurance on balances in excess of the standard limitations.

The Bank also offers customers the convenience of 24-hour banking, seven days a week, through FNCB Online Banking (“FNCB Online”) and FNCB Business Online Banking via a secure website, https://www.fncb.com. FNCB’s online product suite includes bill payment, internal and external funds transfer and POP Money (person to person transfers), and Purchase Rewards. Through FNCB Online, customers can directly access their accounts, open new accounts and apply for a mortgage or obtain a pre-qualification approval through the Bank’s mortgage center. Customers can also access FNCB Online through the Bank’s mobile application. Telephone banking (“Account Link”), a service that provides customers with the ability to access account information and perform related account transfers through the use of a touch tone telephone, is also available. In addition, customers can access money from their deposit accounts by using their debit card to make purchases or withdraw cash from any automated teller machines (“ATMs”) including ATMs located in each of the Bank’s branch offices as well as additional locations. FNCB’s mobile deposit, available to personal banking customers with access to FNCB Online and an eligible deposit account, allows customers to deposit checks, electronically from start to finish, from anywhere at any time.

FNCB Business Online Banking is a menu driven product that provides the Bank’s business customers direct access to their account information and the ability to perform internal and external account transfers, wire transfers and payments through ACH transactions, and process direct deposit payroll transactions for employees, 24 hours a day, 7 days a week, from their place of business.

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The Bank also offers business customers remote deposit capture and merchant services, as well as business debit cards. Remote deposit capture provides business customers the ability to process daily check deposits to their accounts through an online image capture environment. The Bank offers business customers merchant payment processing solutions, including state-of-the-art credit card terminals, integrated payment systems and a dedicated account manager. Business customers can also access money from their deposit account by using their “business” debit card, providing a faster, more convenient way to make purchases, track business expenses and manage finances.

The Bank offers several overdraft protection products including Bounce Protection, Instant Money and transfer from another FNCB checking or savings account, which provide customers with an added level of protection against unanticipated overdrafts due to cash flow emergencies and account reconciliation errors.

Lending Activities

FNCB offers a variety of loans, including residential real estate loans, construction, land acquisition and development loans, commercial real estate loans, commercial and industrial loans, loans to state and political subdivisions, and consumer loans, generally to individuals and businesses in its primary market area. These lending activities are described in further detail below.

Residential Mortgage Loans and Home Equity Term Loans

FNCB offers a variety of fixed-rate one- to four-family residential loans and home equity term loans. FNCB’s suite of residential mortgage products include First Time Homebuyer mortgages, FHA and Home Possible® mortgages with low down payments to meet the home financing needs of customers. Home equity term loans have fixed interest rates with terms up to 15 years. FNCB also offers a proprietary “WOW” mortgage, a first-lien, fixed-rate mortgage product with maturity terms ranging from 7.5 to 14.5 years. At December 31, 2018, one- to four-family residential mortgage loans totaled $164.8 million, or 19.7%, of the total loan portfolio. Except for the WOW mortgage, one- to four-family mortgage loans are originated generally for sale in the secondary market. However, FNCB may hold in portfolio one- to four-family residential mortgage loans as deemed necessary according to current asset/liability management strategies. During the year ended December 31, 2018, the Bank sold $9.6 million of one- to four-family mortgages. FNCB retains servicing rights on these mortgages.

Construction, Land Acquisition and Development Loans

FNCB offers interim construction financing secured by residential property for the purpose of constructing one- to four-family homes. FNCB also offers interim construction financing for the purpose of constructing residential developments and various commercial properties including shopping centers, office complexes and single purpose owner-occupied structures and for land acquisition. At December 31, 2018, construction, land acquisition and development loans amounted to $20.8 million and represented 2.5% of the total loan portfolio.

Commercial Real Estate Loans

Commercial real estate loans represent the largest portion of FNCB's total loan portfolio and loans in this portfolio generally have larger loan balances. These loans are secured by a broad range of real estate, including but not limited to, office complexes, shopping centers, hotels, warehouses, gas stations, convenience markets, residential care facilities, nursing care facilities, restaurants, multifamily housing, farms and land subdivisions. At December 31, 2018, FNCB's commercial real estate loans totaled $262.8 million, or 31.5%, of the total loan portfolio.

Commercial and Industrial Loans

FNCB generally offers commercial loans to sole proprietors and businesses located in its primary market area. The commercial loan portfolio includes, but is not limited to, lines of credit, dealer floor plan lines, equipment loans, vehicle loans and term loans. These loans are primarily secured by vehicles, machinery and equipment, inventory, accounts receivable, marketable securities and deposit accounts. At December 31, 2018, FNCB's commercial and industrial loans totaled $151.0 million, or 18.1%, of the total loan portfolio.

Consumer Loans

Consumer loans include indirect automobile loans originated through various auto dealers in the Bank's market area, secured and unsecured installment loans, direct new and used automobile financing, home equity and personal lines of credit and overdraft protection loans. Home equity lines of credit have adjustable interest rates based on the National prime interest rate and are offered up to a maximum combined loan-to-value ratio of 90%, based on the property's appraised value. At December 31, 2018, FNCB's consumer loans totaled $176.8 million, or 21.2%, of the total loan portfolio.

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State and Political Subdivision Loans

FNCB originates state and political subdivision loans, including general obligation and tax anticipation notes, primarily to municipalities in the Bank's market area. At December 31, 2018, FNCB's state and political subdivision loans totaled $59.0 million, or 7.1%, of the total loan portfolio.

For more information regarding FNCB's loan portfolio and lending policies, please refer to Note 2, "Summary of Significant Accounting Policies" to the consolidated financial statements included in Item 8 of this Annual Report on Form 10-K.

Wealth Management

FNCB offers customers wealth management services through a third-party provider. Customers are able to access alternative deposit products such as mutual funds, annuities, stocks, and bonds directly for purchase from an outside provider.

Deposit Activities

In general, deposits, borrowings and loan repayments are the major sources of funding for lending and other investment purposes. FNCB relies primarily on marketing, product innovation, technology and service to attract, grow and retain its deposits. Deposit account terms vary according to the minimum balance required, the time periods the funds must remain on deposit and the interest rate, among other factors. In determining the terms of deposit accounts, management considers the interest rates offered by its competitors, the interest rates available on FHLB advances and other wholesale funding, its liquidity needs and customer preferences. Management regularly reviews FNCB's deposit mix and deposit pricing as part of its asset/liability management, taking into consideration rates offered by competitors in its market area and balance sheet interest-rate sensitivity.

Competition

The banking and financial services industries are highly competitive. FNCB faces direct competition in originating loans and in attracting deposits from a significant number of financial institutions operating in its market area, many with a statewide or regional presence, and in some cases, a national presence, as well as other financial and non-financial institutions outside of its market area through online loan and deposit product offerings. The competition comes principally from other banks, savings institutions, credit unions, mortgage banking companies, internet-based financial technology (“FinTech”) companies and, with respect to deposits, institutions offering investment alternatives, including money market funds and online deposit accounts. The increased competition has resulted from changes in the legal and regulatory guidelines, as well as from economic conditions. The cost of regulatory compliance remains high for community banks as compared to their larger competitors that are able to achieve economies of scale.

As a result of consolidation in the banking industry, some of the Bank’s competitors and their respective affiliates are larger and may enjoy advantages such as greater financial resources, a wider geographic presence, a wider array of services, or more favorable pricing alternatives and lower origination and operating costs. FNCB considers its major competitors to be local commercial banks as well as other commercial banks with branches in its market area. Competitors may offer deposits at higher rates and loans with lower fixed rates, more attractive terms and less stringent credit structures than FNCB has been able to offer. The growth and profitability of FNCB depends on its continued ability to successfully compete. Management believes interest rates on deposits, especially money market and time deposits, and interest rates and fees charged on loans within FNCB’s market area to be very competitive.

Supervision and Regulation

FNCB and the Bank operate in a highly regulated industry and is subject to a variety of statutes, regulations and policies, as well as ongoing regulatory supervision and review. Federal statutes that apply to FNCB and the Bank include the Gramm Leach Bliley Act (“GLB Act”), the Bank Holding Company Act (“BHCA”), the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), the USA Patriot Act, the Federal Reserve Act and the Federal Deposit Insurance Act. In general, these statutes, regulations promulgated in accordance with these statutes, and interpretations of the statutes and regulations by the banking regulatory agencies establish the eligible business activities of FNCB and the Bank, certain acquisition and merger restrictions, limitations on intercompany transactions, such as loans and dividends, and capital adequacy requirements, among other things. These laws, regulations and policies are subject to frequent change and FNCB takes measures to comply with applicable requirements.The following summarizes some of the more significant provisions of these laws as they relate to FNCB and the Bank.

FNCB

FNCB is a bank holding company within the meaning of the BHCA and is registered with, and subject to regulation and examination by, the Board of Governors of the Federal Reserve System (“FRB”). FNCB is required to file annual and quarterly reports with the FRB and to provide the FRB with such additional information that they may require. BHCA and other federal laws subject bank holding companies to restrictions on the types of activities in which they may engage, and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations and unsafe and unsound banking practices.

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The BHCA requires approval of the FRB for, among other things, the acquisition of direct or indirect ownership or control of more than five percent (5%) of the voting securities or substantially all the assets of any bank or bank holding company, or before the merger or consolidation with another bank holding company.

With certain limited exceptions, a bank holding company is prohibited from acquiring control of any voting shares of any company which is not a bank or bank holding company and from engaging directly or indirectly in any activity other than banking or managing or controlling banks or furnishing services to or performing services for its authorized subsidiaries. A bank holding company may, however, engage in, or acquire an interest in a company that engages in, activities that the FRB has determined by order or regulation to be so closely related to banking or managing or controlling banks as to be properly incident thereto. In making such a determination, the FRB is required to consider whether the performance of such activities can reasonably be expected to produce benefits to the public, such as convenience, increased competition or gains in efficiency, which outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices. The FRB is also empowered to differentiate between activities commenced *de novo* and activities commenced by the acquisition, in whole or in part, of a going concern. Some of the activities that the FRB has determined by regulation to be closely related to banking include making or servicing loans, performing certain data processing services, acting as a fiduciary or investment or financial advisor, and making investments in corporations or projects designed primarily to promote community welfare.

Subsidiary banks of a bank holding company are subject to certain restrictions imposed by the Federal Reserve Act on any extensions of credit to the bank holding company or any of its subsidiaries, or investments in the stock or other securities thereof, and on the taking of such stock or securities as collateral for loans to any borrower. Further, a holding company and any subsidiary bank are prohibited from engaging in certain tie-in arrangements in connection with the extension of credit.

The GLB Act allows a bank holding company or other company to certify status as a financial holding company, which allows such company to engage in activities that are financial in nature, that are incidental to such activities, or are complementary to such activities without further approval. The GLB Act enumerates certain activities that are deemed financial in nature, such as underwriting insurance or acting as an insurance principal, agent or broker, underwriting, dealing in or making markets in securities, and engaging in merchant banking under certain restrictions. The GLB Act also authorizes the FRB to determine by regulation what other activities are financial in nature, or incidental or complementary thereto. FNCB has not elected to be treated as a financial holding company.

FNCB also is subject to the jurisdiction of the Securities and Exchange Commission (“SEC”) and is subject to the disclosure and regulatory requirements under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended

FNCB's shares of common stock began trading on the Nasdaq Capital Market on March 5, 2018. Accordingly, FNCB is now subject to certain financial, liquidity and corporate governance requirements imposed by Nasdaq. Non-compliance of these requirements could subject FNCB to potential denial of listing, or additional conditions, as necessary, to protect investors and the public interest. Prior to March 5, 2018, FNCB's shares of common stock traded on the OTCQX marketplace under the symbol "FNCB".

The Bank

Effective June 30, 2016, upon its conversion to a state charter, the Bank is regulated by the Pennsylvania Department of Banking and Securities ("PADOBS"). The Bank's deposit accounts are insured up to the maximum legal limit by the Deposit Insurance Fund of the FDIC and accordingly, the Bank is also regulated by the FDIC. The regulations of the PADOBS and the FDIC govern most aspects of the Bank's business, including required reserves against deposits, loans, investments, mergers and acquisitions, borrowings, dividends and location and number of branch offices. The laws and regulations governing the Bank generally have been promulgated to protect depositors and the Deposit Insurance Fund, and not to protect shareholders.

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Branching and Interstate Banking. The federal banking agencies are generally authorized to approve interstate bank merger transactions

The Dodd-Frank Act amended federal banking law to permit banks to establish *de novo* branches in other states to the same extent as a bank chartered by that state would be so permitted. The interstate banking and branching provisions of the t federal banking laws would permit the Bank to merge with banks in other states and branch into other states and would also permit banks from other states to acquire banks in the Bank's market area and to establish *de novo* branches in the Bank’s market area.

USA Patriot Act and the Bank Secrecy Act (“BSA”). Under the BSA, a financial institution is required to have systems in place to detect certain transactions, based on the size and nature of the transaction. Financial institutions are generally required to report cash transactions involving more than \$10,000 to the United States Treasury. In addition, financial institutions are required to file suspicious activity reports for transactions that involve more than \$5,000 and that the financial institution knows, suspects or has reason to suspect, involves illegal funds, is designed to evade the requirements of the BSA or has no lawful purpose. Under the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act, commonly referred to as the “USA Patriot Act” or the “Patriot Act,” financial institutions are subject to prohibitions against specified financial transactions and account relationships, as well as enhanced due diligence standards intended to detect, and prevent, the use of the United States financial system for money laundering and terrorist financing activities. The Patriot Act requires financial institutions, including banks, to establish anti-money laundering programs, including employee training and independent audit requirements, meet minimum specified standards, follow minimum standards for customer identification and maintenance of customer identification records, and regularly compare customer lists against lists of suspected terrorists, terrorist organizations and money launderers.

Capital Adequacy Requirements. Federal banking agencies have adopted risk based capital adequacy and leverage capital adequacy requirements pursuant to which they assess the adequacy of capital in examining and supervising banks and bank holding companies and in analyzing bank regulatory applications. Risk-based capital requirements determine the adequacy of capital based on the risk inherent in various classes of assets and off-balance sheet items.

FNCB and the Bank are subject to extensive and detailed capital requirements, as modified by and changes imposed by the Dodd-Frank Act (“Basel III”). Basel III calls for the following capital requirements:

A minimum ratio of common equity tier I (“CET I”) capital to risk-weighted assets of 4.5%.
A minimum ratio of tier I capital to risk-weighted assets of 6%.
A minimum ratio of total capital to risk-weighted assets of 8%.
A minimum leverage ratio of 4%.

Basel III also establishes a "countercyclical capital buffer," that is designed to absorb losses during periods of economic stress. Generally, the capital conservation buffer of 2.50% of risk-weighted assets will be imposed when federal banking regulators determine that excess aggregate credit growth becomes associated with a buildup of systemic risk. For all banking institutions, the phase-in period for the capital conservation buffer requirement began on January 1, 2016 at 0.625% and increased by that amount each year until it reached the full 2.50% on January 1, 2019.

Banking institutions with a ratio of CET I to risk-weighted assets above the minimum but below the conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, when the latter is applied) may face constraints on their ability to pay dividends, to effect equity repurchases and pay discretionary bonuses to executive officers, which constraints vary based on the amount of the shortfall.

Basel III also included, as part of the definition of CET I capital, a requirement that banking institutions include the amount of Accumulated Other Comprehensive Income ("AOCI"), which primarily consists of unrealized gains and losses, net of tax, on available-for-sale securities, that are not other than temporarily impaired ("OTTI") in calculating regulatory capital, unless the institution makes a one-time opt-out election from this provision in connection with the filing of its first regulatory reports after applicability of the Basel III Rule to that institution. The Basel III Rule also imposes a 4.00% minimum Tier I leverage ratio. FNCB and the Bank elected to exclude AOCI in calculating regulatory capital.

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Basel III provides for new deductions from and adjustments to CET I. These include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities be deducted from CET I to the extent that any one such category exceeds 10.00% of CET I or all such categories in the aggregate exceed 15.00% of CET I.

Basel III imposed changes to methodologies for determining risk weighted assets, including revisions to recognition of credit risk mitigation, such as a greater recognition of financial collateral and a wider range of eligible guarantors, the risk weighting of equity exposures and past due loans, and higher (greater than 100%) risk weighting for certain commercial real estate exposures that have higher credit risk profiles, including higher loan to value and equity components.

As discussed below, Basel III also integrates the new capital requirements into the prompt corrective action provisions under Section 38 of the Federal Deposit Insurance Act ("FDIA").

Prompt Corrective Action. Under Section 38 of the FDIA, each federal banking agency is required to implement a system of prompt corrective action for institutions which it regulates. The federal banking agencies have promulgated substantially similar regulations to implement the system of prompt corrective action established by Section 38 of the FDIA.

The following are the capital requirements under the Basel III Rules integrated into the prompt corrective action category definitions. As of December 31, 2018, the following capital requirements were applicable to the Bank for purposes of Section 38 of the FDIA.

Capital Category	**Total Risk-Based Capital Ratio**	**Tier I Risk-Based Capital Ratio**	**CET I Capital Ratio**	**Leverage Ratio**	**Tangible Equity to Assets**
Well capitalized	>/= 10.0%	>/= 8.0%	>/= 6.5%	>/= 5.0%	N/A
Adequately capitalized with conservation buffer	>/= 9.875%	>/= 7.875%	>/= 6.375%	>/= 4.0%	N/A
Adequately capitalized	>/= 8.0%	>/= 6.0%	>/= 4.5%	>/= 4.0%	N/A
Undercapitalized	< 8.0%	< 6.0%	< 4.5%	< 4.0%	N/A
Significantly undercapitalized	< 6.0%	< 4.0%	< 3.0%	< 3.0%	N/A
Critically undercapitalized	N/A	N/A	N/A	N/A	Less than 2.0%

Additionally, FNCB’s outstanding subordinated notes are subject to phase out and will cease to qualify as capital for regulatory purposes. Overall, management believes that implementation of Basel III did not have a material adverse effect on FNCB’s or the Bank’s capital ratios, earnings, shareholder’s equity, or its ability to pay discretionary bonuses to executive officers. At December 31, 2018, the Bank was “well capitalized” under the aforementioned requirements with a common equity Tier I capital and Tier I capital to risk-weighted assets ratios of 11.11%, a total capital to risk-weighted assets ratio of 12.17% and a Leverage ratio of 8.27%. Similarly, at December 31, 2018, FNCB met its capital requirements with a common equity Tier I capital to risk-weighted assets of 11.42%, a Tier I capital to risk-weighted assets ratio of 10.47%, a total capital to risk-weighted assets ratio of 12.69%, and a Leverage ratio of 8.50%.

Regulatory Enforcement Authority. Federal banking law grants substantial enforcement powers to federal banking regulators. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities.

The Bank and its “institution-affiliated parties,” including its management, employees, agents, independent contractors, consultants such as attorneys and accountants and others who participate in the conduct of the financial institution’s affairs, are subject to potential civil and criminal penalties for violations of law, regulations or written orders of a governmental agency. In addition, regulators are provided with greater flexibility to commence enforcement actions against institutions and institution-affiliated parties. Possible enforcement actions include the termination of deposit insurance and cease-and-desist orders. Such orders may, among other things, require affirmative action to correct any harm resulting from a violation or practice, including restitution, reimbursement, indemnifications or guarantees against loss. A financial institution may also be ordered to restrict its growth, dispose of certain assets, rescind agreements or contracts, or take other actions as determined by the ordering agency to be appropriate.

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Under provisions of the federal securities laws, a determination by a court or regulatory agency that certain violations have occurred at a company or its affiliates can result in fines, restitution, a limitation of permitted activities, disqualification to continue to conduct certain activities and an inability to rely on certain favorable exemptions. Certain types of infractions and violations can also affect a public company in its timing and ability to expeditiously issue new securities into the capital markets.

The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss allowances for regulatory purposes.

The Dodd-Frank Act. The Dodd-Frank Act made significant changes to the bank regulatory structure and affects the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. To date, the following provisions of the Dodd-Frank Act are considered to be of the greatest significance to FNCB:

- expands the authority of the FRB to examine bank holding companies and their subsidiaries, including insured depository institutions;

- requires a bank holding company to be well capitalized and well managed to receive approval of an interstate bank acquisition;

- provides mortgage reform provisions regarding a customer's ability to pay and making more loans subject to provisions for higher-cost loans and new disclosures;

- creates the Consumer Financial Protection Bureau (the "CFPB") that has rulemaking authority for a wide range of consumer protection laws that apply to all banks and has broad powers to supervise and enforce consumer protection laws;

- creates the Financial Stability Oversight Council with authority to identify institutions and practices that might pose a systemic risk;

- introduces additional corporate governance and executive compensation requirements on companies' subject to the Securities and Exchange Act of 1934, as amended;

- permits FDIC-insured banks to pay interest on business demand deposits;

requires that holding companies and other companies that directly or indirectly control an insured depository institution serve as a source of financial strength;

makes permanent the $250 thousand limit for federal deposit insurance at all insured depository institutions; and

permits national and state banks to establish interstate branches to the same extent as the branch host state allows establishment of in-state branches.

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C*onsumer Financial Protection Bureau.* The Dodd-Frank Act created the CFPB, which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act ("TILA"), Real Estate Settlement Procedures Act ("RESPA"), Fair Credit Reporting Act, Fair Debt Collection Act, Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act, and certain other statutes. The CFPB has examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Smaller institutions are subject to rules promulgated by the CFPB, but continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB has authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. The Dodd-Frank Act authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower's ability to repay. In addition, the Dodd-Frank Act allows borrowers to raise certain defenses to foreclosure if they receive any loan other than a "qualified mortgage" as defined by the CFPB. The Dodd-Frank Act permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

Ability to Repay and Qualified Mortgage Rule

Pursuant to the Dodd Frank in 2014 the CFPB amended Regulation Z as implemented by the Truth in Lending Act, requiring mortgage lenders to make a reasonable and good faith determination based on verified and documented information that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Mortgage lenders are required to determine consumers' ability to repay in one of two ways. The first alternative requires the mortgage lender to consider the following eight underwriting factors when making the credit decision:

- current or reasonably expected income or assets;
- current employment status;
- the monthly payment on the covered transaction;
- the monthly payment on any simultaneous loan;
- the monthly payment for mortgage-related obligations;
- current debt obligations, alimony, and child support;
- the monthly debt-to-income ratio or residual income; and

• credit history.

Alternatively, the mortgage lender can originate “qualified mortgages,” which are entitled to a presumption that the creditor making the loan satisfied the ability-to-repay requirements. In general, a “qualified mortgage” is a mortgage loan without negative amortization, interest-only payments, balloon payments, or terms exceeding 30 years. In addition, to be a qualified mortgage, the points and fees paid by a consumer cannot exceed 3% of the total loan amount. Loans which meet these criteria will be considered qualified mortgages, and as a result generally protect lenders from fines or litigation in the event of foreclosure. Qualified mortgages that are “higher-priced” (e.g. subprime loans) garner a rebuttable presumption of compliance with the ability-to-repay rules, while qualified mortgages that are not “higher-priced” (e.g. prime loans) are given a safe harbor of compliance. The rule did not have a material impact on our lending activities or our results of operations or financial condition.

TILA/RESPA Integrated Disclosures (“TRID”). In 2015, the CFPB implemented a rule combining the mortgage disclosures consumers previously received under TILA and RESPA. For more than 30 years, the TILA and RESPA mortgage disclosures had been administered separately by, respectively, the Federal Reserve Board and the U.S. Department of Housing and Urban Development. The rule requires lenders to provide applicants with the new Loan Estimate and Closing Disclosure and generally applies to most closed-end consumer mortgage loans.

The CFPB’s rulemaking, examination and enforcement authority has and will continue to significantly affect financial institutions offering consumer financial products and services, including FNCB and the Bank. These regulatory activities may limit the types of financial services and products the Bank may offer, which in turn may reduce FNCB’s revenues.

FDIC Insurance Premiums. The FDIC maintains a risk-based assessment system for determining deposit insurance premiums. Four risk categories (I-IV), each subject to different premium rates, are established based upon an institution’s status as well capitalized, adequately capitalized or undercapitalized, and the institution’s supervisory rating.

The Dodd-Frank Act permanently increased the maximum deposit insurance amount for banks, savings institutions and credit unions to $250,000 per depositor. The Dodd-Frank Act also broadened the base for FDIC insurance assessments. Assessments are now based on a financial institution’s average consolidated total assets less tangible equity capital. The Dodd-Frank Act requires the FDIC to increase the reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35% of insured deposits by 2020 and eliminates the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. The Dodd-Frank Act eliminated the statutory prohibition against the payment of interest on business checking accounts.

An insured institution is required to pay deposit insurance premiums on its assessment base in accordance with its risk category. There are three adjustments that can be made to an institution’s initial base assessment rate: (1) a potential decrease for long-term unsecured debt, including senior and subordinated debt and, for small institutions, a portion of Tier I capital; (2) a potential increase for secured liabilities above a threshold amount; and (3) for non-Risk Category I institutions, a potential increase for brokered deposits above a threshold amount. The FDIC may also impose special assessments from time to time.

At December 31, 2018, the Bank was considered risk category I, the lowest risk category, for deposit insurance assessments and paid an annual assessment rate ranging from 0.0005 basis points to 0.0006 basis points on the assessment base of average consolidated total assets less the average tangible equity during the assessment period.

May 2018 Banking Reform Legislation

On May 24, 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act (the "Regulatory Relief Act"), amended certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, as well as certain other statutes administered by the federal banking agencies. Some of the key provisions of the Regulatory Relief Act as it relates to community banks and bank holding companies include: (i) designating mortgages held in portfolio as "qualified mortgages" for banks with less than $10 billion in assets, subject to certain documentation and product limitations; (ii) exempting banks with less than $10 billion in assets (and total trading assets and trading liabilities of 5% or less of total assets) from Volcker Rule requirements relating to proprietary trading; (iii) simplifying capital calculations for banks with less than $10 billion in assets by requiring federal banking agencies to establish a community bank leverage ratio of tangible equity to average consolidated assets of not less than 8% or more than 10%, and provide that banks that maintain tangible equity in excess of such ratio will be deemed to be in compliance with risk-based capital and leverage requirements; (iv) assisting smaller banks with obtaining stable funding by providing an exception for reciprocal deposits from FDIC restrictions on acceptance of brokered deposits; (v) raising the eligibility for use of short-form Call Reports from $1 billion to $5 billion in assets; (vi) clarifying definitions pertaining to high volatility commercial real estate loans (HVCRE), which require higher capital allocations, so that only loans with increased risk are subject to higher risk weightings; and (vii) changing the eligibility for use of the small bank holding company policy statement from institutions with under $1 billion in assets to institutions with under $3 billion in assets.

Section 201 of the Regulatory Relief Act directed the federal banking agencies to develop a community bank leverage ratio ("CBLR") of not less than 8% and not more than 10% for qualifying community banks and bank holding companies with total consolidated assets of less than $10 billion. Qualifying community banking organizations that exceed the CBLR level established by the agencies, and that elect to be covered by the CBLR framework, will be considered to have met: (i) the generally applicable leverage and risk-based capital requirements under the banking agencies' capital rules; (ii) the capital ratio requirements necessary to be considered "well capitalized" under the banking agencies' prompt corrective action framework in the case of insured depository institutions; and (iii) any other applicable capital or leverage requirements.

On February 8, 2019, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve Board, and the FDIC published for comment a proposed rule to implement the provisions of Section 201 of the Regulatory Relief Act. Under the proposal, a qualifying community banking organization would be defined as a depository institution or depository institution holding company with less than $10 billion in assets and specified limited amounts of off-balance sheet exposures, trading assets and liabilities, mortgage servicing assets, and certain temporary difference deferred tax assets. A qualifying community banking organization would be permitted to elect the CBLR framework if its CBLR is greater than 9%. The proposed rulemaking also addresses opting in and opting out of the CBLR framework by a community banking organization, the treatment of a community banking organization that falls below CBLR requirements, and the effect of various CBLR levels for purposes of the prompt corrective action categories applicable to insured depository institutions. Advanced approaches banking organizations (generally, institutions with $250 billion or more in consolidated assets) are not eligible to use the CBLR framework.

FNCB continues to analyze the changes implemented by the Regulatory Relief Act, including the CBLR framework included in the recently proposed rulemaking. FNCB has not determined at this time whether or not it would qualify for the CBLR framework or, if so, whether it would elect to utilize the CBLR framework. FNCB does not believe, however, that the changes resulting from the Regulatory Relief Act will materially impact FNCB's business, operations, or financial results.

Dividend Restrictions

FNCB is a legal entity separate and distinct from the Bank. FNCB 's revenues (on a parent company only basis) and its ability to pay dividends to its shareholders are almost entirely dependent upon the receipt of dividends from the Bank. The right of FNCB , and consequently the rights of its creditors and shareholders to participate in any distribution of the assets or earnings of any subsidiary through the payment of such dividends or otherwise is necessarily subject to the prior claims of creditors of the subsidiary (including depositors) except to the extent that claims of FNCB , in its capacity as a creditor, may be recognized. Additionally, the ability of the Bank to pay dividends to FNCB is subject to Pennsylvania state law and various regulatory restrictions.

The declaration of cash dividends on FNCB's common stock is at the discretion of its board of directors, and any decision to declare a dividend is based on a number of factors, including, but not limited to, earnings, prospects, financial condition, regulatory capital levels, applicable covenants under any credit agreements, notes and other contractual restrictions, Pennsylvania law, federal bank regulatory law, and other factors deemed relevant.

Employees

As of December 31, 2018, FNCB, including the Bank employed 239 persons, including 27 part-time employees.

Available Information

FNCB files reports, proxy and information statements and other information electronically with the SEC. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The SEC's website site address is https://www.sec.gov. FNCB makes its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K and amendments thereto available through its website at https://www.fncb.com. The information contained on our website is not included as a part of, or incorporated by reference in, this Annual Report on Form 10-K. These reports may also be obtained free of charge as soon as practicable after filing or furnishing them to the SEC upon request by sending an email to corporatesecretary@fncb.com. Information may also be obtained via written request to FNCB Bancorp, Inc. Attention: Chief Financial Officer, 102 East Drinker Street, Dunmore, PA 18512.

Item 1A. Risk Factors

The operations and financial results of FNCB are subject to various risks and uncertainties, including those described below. The risks and uncertainties described below are not the only ones the Company faces. Additional risks and uncertainties the Company is unaware of, or the Company currently believes are not material, may also become important factors affecting the Company. If any of the following risks occur, the Company's business, financial condition, operating results and prospects could be materially and adversely affected. In that event, the price of the Company's common stock could decline.

Risks Related to FNCB's Business

FNCB is subject to credit risk, which could adversely affect its profitability.

FNCB's business depends on its ability to successfully measure and manage credit risk. As a lender, FNCB is exposed to the risk that the principal of, or interest on, a loan will not be paid timely or at all or that the value of any collateral supporting a loan will be insufficient to cover FNCB's outstanding exposure. In addition, FNCB is exposed to risks with respect to the period of time over which the loan may be repaid, risks relating to loan underwriting, risks resulting from changes in economic and industry conditions, and risks inherent in dealing with individual loans and borrowers. The creditworthiness of a borrower is affected by many factors including local market conditions and general economic conditions. If the overall economic climate in the United States generally, or in the market areas specifically, experiences material disruption, FNCB's borrowers may experience difficulties in repaying their loans, the collateral FNCB holds may decrease in value or become illiquid, and FNCB's level of nonperforming loans, charge-offs and delinquencies could rise and require significant additional provisions for loan losses.

FNCB's risk management practices, such as monitoring the concentrations of its loans and its credit approval, review and administrative practices, may not adequately reduce credit risk, and FNCB's credit administration personnel, policies and procedures may not adequately adapt to changes in economic or any other conditions affecting related customers and the quality of the loan portfolio. Many of FNCB's loans are made to small businesses that are less able to withstand competitive, economic and financial pressures than larger borrowers. Consequently, FNCB may have significant exposure if any of these borrowers becomes unable to pay their loan obligations as a result of economic or market conditions, or personal circumstances, such as divorce, unemployment or death. A failure to effectively measure and limit the credit risk associated with FNCB's loan portfolio may result in loan defaults, foreclosures and additional charge-offs, and may necessitate that FNCB significantly increase FNCB's allowance for loan losses, each of which could adversely affect FNCB's net income. As a result, FNCB's inability to successfully manage credit risk could have a material adverse effect on its business, financial condition and results of operations.

Weakness in the economic environment, in general, and within FNCB's market area could pose significant challenges for FNCB and could adversely affect its financial condition and results of operations.

FNCB's success depends primarily on the general economic conditions in the Commonwealth of Pennsylvania and the specific local markets in which it operates. Unlike larger national or other regional banks that are more geographically diversified, FNCB provides banking and financial services to customers primarily in the Lackawanna, Luzerne, Lehigh and Wayne County markets. The local economic conditions in these areas have a significant impact on the demand for FNCB's products and services as well as the ability of customers to repay loans, the value of the collateral securing loans, and the stability of deposit funding sources. A significant decline in general economic conditions, caused by inflation, recession, acts of terrorism, severe weather or natural disasters, outbreak of hostilities or other international or domestic occurrences, unemployment, changes in securities markets or other factors could impact these local economic conditions and, in turn, have a material adverse effect on FNCB's financial condition and results of operations. Specifically, weakness in economic conditions could result in one or more of the following:

- A decrease in the demand for FNCB's loans and other products and services;
- A decrease in customer savings generally and in the demand for FNCB's savings and other deposit products; and
- An increase in the number of customers and counterparties who become delinquent, file for protection under bankruptcy laws, or default on their loans or other obligations.

An increase in the number of delinquencies, bankruptcies, or defaults could result in a higher level of non-performing assets, net charge-offs, and provision for loan and lease losses. The markets FNCB serves are dependent on retail and service-related businesses and, thus, are particularly vulnerable to adverse changes in economic conditions affecting these sectors.

To the extent that economic conditions deteriorate, business and individual borrowers may be less able to meet their obligations to the Bank in full, in a timely manner, resulting in decreased earnings or losses to the Bank. To the extent that loans are secured by real estate, adverse conditions in the real estate market may reduce the ability of the borrowers to generate the necessary cash flow for repayment of the loan, and reduce the ability to collect the full amount of the loan upon a default. To the extent that the Bank makes fixed-rate loans, general increases in interest rates will tend to reduce its spread as the interest rates FNCB must pay for deposits would increase while interest income is flat. Economic conditions and interest rates may also adversely affect the value of property pledged as security for loans.

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FNCB's loan portfolio contains a significant number of commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in non-performing loans.

As of December 31, 2018, approximately 34.0% of FNCB's loan portfolio consisted of commercial real estate loans and construction, land acquisition and development loans. These types of loans are generally viewed as having a higher risk of default than residential real estate loans or consumer loans. These types of loans are also typically larger than residential real estate loans and consumer loans. Because FNCB's loan portfolio contains a significant number of commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in non-performing loans. All non-performing loans totaled $4.7 million, or 0.56% of total gross loans, as of December 31, 2018, and $2.6 million, or 0.34% of total gross loans, as of December 31, 2017. Although non-performing loans as a percentage of gross loans remained steady from the prior year, an increase in non-performing loans in the future could result in an increase in the provision for loan and lease losses and an increase in loan charge-offs, both of which could have a material adverse effect on FNCB's financial condition and results of operations. The lending activities in which the Bank engages carry the risk that the borrowers will be unable to perform on their obligations. As such, general economic conditions, nationally and in FNCB's primary market area, will have a significant impact on its results of operations.

FNCB's concentrations of loans, including those to insiders and related parties, may create a greater risk of loan defaults and losses.

A substantial portion of FNCB's loans are secured by real estate in the Northeastern Pennsylvania market, and substantially all of its loans are to borrowers in that area. FNCB also has a significant amount of commercial real estate, commercial and industrial, construction, land acquisition and development loans and land-related loans for residential and commercial developments. At December 31, 2018, $468.1 million, or 56.1%, of gross loans were secured by real estate, primarily commercial real estate. Management has taken steps to mitigate commercial real estate concentration risk by diversification among the types and characteristics of real estate collateral properties, sound underwriting practices, and ongoing portfolio monitoring and market analysis. Of total gross loans, $20.8 million, or 2.5%, were construction, land acquisition and development loans. Construction, land acquisition and development loans have the highest risk of uncollectability. An additional $151.0 million, or 18.1%, of portfolio loans were commercial and industrial loans not secured by real estate. Historically, commercial and industrial loans generally have had a higher risk of default than other categories of loans, such as single family residential mortgage loans. The repayment of these loans often depends on the successful operation of a business and are more likely to be adversely affected by adverse economic conditions. While management believes that the loan portfolio is well diversified in terms of borrowers and industries, these concentrations expose FNCB to the risk that adverse developments in the real estate market, or in the general economic conditions in its general market area, could increase the levels of non-performing loans and charge-offs, and reduce loan demand. In that event, FNCB would likely experience lower earnings or losses. Additionally, if, for any reason, economic conditions in its market area deteriorate, or there is significant volatility or weakness in the economy or any significant sector of the area's economy, FNCB's ability to develop business relationships may be diminished, the quality and collectability of its loans may be adversely affected, the value of collateral may decline and loan demand may be reduced.

Commercial real estate, commercial and industrial and construction, land acquisition and development loans tend to have larger balances than single family mortgage loans and other consumer loans. Because FNCB's loan portfolio contains a significant number of commercial and industrial loans, commercial real estate loans and construction, land acquisition and development loans with relatively large balances, the deterioration of one or a few of these loans may cause a significant increase in non-performing assets. An increase in non-performing loans could result in a loss of earnings from these loans, an increase in the provision for loan and lease losses, or an increase in loan charge-offs, which could have an adverse impact on FNCB's results of operations and financial condition.

Guidance adopted by federal banking regulators provides that banks having concentrations in construction, land development or commercial real estate loans are expected to have and maintain higher levels of risk management and, potentially, higher levels of capital, which may adversely affect shareholder returns, or require FNCB to obtain additional capital sooner than it otherwise would. Excluded from the scope of this guidance are loans secured by non-farm nonresidential properties where the primary source of repayment is the cash flow from the ongoing operations and activities conducted by the party, or affiliate of the party, who owns the property.

Outstanding loans and line of credit balances to directors, officers and their related parties totaled $64.6 million as of December 31, 2018. At December 31, 2018, there were no loans to directors, officers and their related parties that were categorized as criticized loans within the Bank's risk rating system, meaning they are not considered to present a higher risk of collection than other loans. For more information regarding loans to officers and directors and/or their related parties, please refer to Note 11, "Related Party Transactions" to the consolidated financial statements included in Item 8 and Item 13, "Certain Relationships and Related Transactions, and Director Independence" to this Annual Report on Form 10-K.

FNCB's financial condition and results of operations would be adversely affected if the ALLL is not sufficient to absorb actual losses or if increases to the ALLL were required.

The lending activities in which the Bank engages carry the risk that the borrowers will be unable to perform on their obligations, and that the collateral securing the payment of their obligations may be insufficient to assure repayment. FNCB may experience significant credit losses, which could have a material adverse effect on its operating results. Management makes various assumptions and judgments about the collectability of FNCB's loan portfolio, including the creditworthiness of its borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of its loans, which it uses as a basis to estimate and establish its reserves for losses. In determining the amount of the ALLL, management reviews loans, loss and delinquency experience, and evaluates current economic conditions. If these assumptions prove to be incorrect, the ALLL may not cover inherent losses in FNCB's loan portfolio at the date of its financial statements. Material additions to FNCB's allowance or extensive charge-offs would materially decrease its net income. At December 31, 2018, the ALLL totaled $9.5 million, representing 1.13% of total loans.

Although management believes FNCB's underwriting standards are adequate to manage normal lending risks, it is difficult to assess the future performance of its loan portfolio due to the ongoing economic environment and the state of the real estate market. The assessment of future performance of the loan portfolio is inherently uncertain. FNCB can give no assurance that non-performing loans will not increase or that non-performing or delinquent loans will not adversely affect its future performance.

In addition, federal and state regulators periodically review the ALLL and may require increases to the ALLL or further loan charge-offs. Any increase in ALLL or loan charge-offs as required by these regulatory agencies could have a material adverse effect on FNCB's results of operations and financial condition.

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If management concludes that the decline in value of any of FNCB's investment securities is other-than-temporary, FNCB is required to write down the security to reflect credit-related impairments through a charge to earnings.

Management reviews FNCB's investment securities portfolio at each quarter-end reporting period to determine whether the fair value is below the current carrying value. When the fair value of any of FNCB's debt investment securities has declined below its carrying value, management is required to assess whether the decline represents an OTTI. If management concludes that the decline is other-than-temporary, it is required to write down the value of that security to reflect the credit-related impairments through a charge to earnings. Changes in the expected cash flows of securities in FNCB's portfolio and/or prolonged price declines in future periods may result in OTTI, which would require a charge to earnings. Due to the complexity of the calculations and assumptions used in determining whether an asset is impaired, any impairment disclosed may not accurately reflect the actual impairment in the future. In addition, to the extent that the value of any of FNCB's investment securities is sensitive to fluctuations in interest rates, any increase in interest rates may result in a decline in the value of such investment securities.

FNCB held approximately $3.1 million in capital stock of the Federal Home Loan Bank of Pittsburgh ("FHLB") as of December 31, 2018. FNCB must own such capital stock to qualify for membership in the Federal Home Loan Bank system which enables it to borrow funds under the FHLB advance program. If the FHLB were to cease operations, FNCB's business, financial condition, liquidity, capital and results of operations may be materially and adversely affected.

FNCB's risk management framework may not be effective in mitigating risks or losses to the Company.

FNCB's risk management framework is comprised of various processes, systems and strategies, and is designed to manage the types of risk to which FNCB is subject, including, among others, credit, market, liquidity, interest rate and compliance. FNCB's framework also includes financial or other modeling methodologies that involve management assumptions and judgment. FNCB's risk management framework may not be effective under all circumstances and may not adequately mitigate any risk or loss to FNCB. If FNCB's risk management framework is not effective, FNCB could suffer unexpected losses and its business, financial condition, results of operations or growth prospects could be materially and adversely affected. FNCB may also be subject to potentially adverse regulatory consequences.

FNCB's portfolio of loans to small and mid-sized community-based businesses may increase its credit risk.

Many of FNCB's commercial business and commercial real estate loans are made to small business or middle market customers. These businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities and have a heightened vulnerability to economic conditions. If general economic conditions in the market area in which FNCB operates negatively impact this important customer sector, FNCB's results of operations and financial condition may be adversely affected. Moreover, a portion of these loans have been made by FNCB in recent years and the borrowers may not have experienced a complete business or economic cycle. The deterioration of FNCB's borrowers' businesses may hinder their ability to repay their loans with FNCB, which could have a material adverse effect on FNCB's financial condition and results of operations.

FNCB is subject to interest rate risk, which could adversely affect its profitability.

FNCB's profitability, like that of most financial institutions, depends to a large extent on its net interest income, which is the difference between its interest income on interest-earning assets, such as loans and investment securities, and its interest expense on interest-bearing liabilities, such as deposits and borrowings.

Interest rates are highly sensitive to many factors that are beyond FNCB's control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System, or the Federal Reserve. Changes in monetary policy, including changes in interest rates, could influence not only the interest FNCB receives on loans and securities and the interest FNCB pays on deposits and borrowings, but such changes could affect FNCB's ability to originate loans and obtain deposits, the fair value of FNCB's financial assets and liabilities, and the average duration of FNCB's assets. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, FNCB's net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings. Any substantial, unexpected or prolonged change in market interest rates could have a material adverse impact on FNCB's business, financial condition and results of operations.

FNCB uses simulation analysis to model net interest income for various interest rate scenarios over a five-year time horizon. Based on the simulation analysis, FNCB's interest sensitivity profile at December 31, 2018 displayed liability sensitivity in the near term, next 18 months, moving to an asset sensitivity position in the later years of the model. Accordingly, given the current rising rate environment, FNCB would expect decreases in net interest income if interest rates rise over the next 18 months. However, net interest income is projected to trend upwards over the life of the simulation due primarily to higher replacement rates on loans and securities exceeding funding cost increases quarter over quarter. These simulations are based on numerous assumptions, including but not limited to: the nature and timing of interest rate levels, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, reinvestment of asset and liability cash flows, customer behavior in a rising rate environment and other factors. When short-term interest rates rise, the rate of interest FNCB pays on its interest-bearing liabilities may rise more quickly than the rate of interest that FNCB receives on its interest-earning assets, which may cause FNCB's net interest income to decrease.

Additionally, a shrinking yield premium between short-term and long-term market interest rates, a pattern usually indicative of investors' waning expectations of future growth and inflation, commonly referred to as a flattening of the yield curve, typically reduces FNCB's profit margin as FNCB borrows at shorter terms than the terms at which FNCB lends and invests.

In addition, an increase in interest rates could also have a negative impact on FNCB's results of operations by reducing the ability of borrowers to repay their current loan obligations. These circumstances could not only result in increased loan defaults, foreclosures and charge-offs, but also reduce collateral values and necessitate further increases to the allowance for loan losses, which could have a material adverse effect on FNCB's business, financial condition and results of operations.

Changes in interest rates could reduce income, cash flows and asset values.

FNCB's earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest-earning assets such as loans and securities and interest expense paid on interest-bearing liabilities such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond FNCB's control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the FRB. Changes in monetary policy, including changes in interest rates, could influence not only the interest FNCB receives on loans and securities and the amount of interest it pays on deposits and borrowings, but such changes could also affect (i) FNCB's ability to originate loans and obtain deposits, (ii) the fair value of FNCB's financial assets and liabilities, and (iii) the average duration of FNCB's mortgage-backed securities portfolio.

If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and investments, FNCB's net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and investments fall more quickly than the interest rates paid on deposits and other borrowings. Any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on FNCB's financial condition and results of operations.

FNCB may not be able to successfully compete with others for business.

FNCB competes for loans, deposits and investment dollars with numerous regional and national banks and other community banking institutions, online divisions of banks located in other markets as well as other kinds of financial institutions and enterprises, such as securities firms, insurance companies, savings associations, credit unions, mortgage brokers, private lenders and Fintech companies. There is also competition for banking business from competitors outside of its market area. As noted above, FNCB and the Bank are subject to extensive regulations and supervision, including, in many cases, regulations that limit the type and scope of activities. Many competitors have substantially greater resources and may offer certain services that FNCB and the Bank does not provide, and operate under less stringent regulatory environments. The differences in available resources and applicable regulations may make it harder for FNCB to compete profitably, reduce the rates that it can earn on loans and investments, increase the rates it must offer on deposits and other funds, and adversely affect its overall financial condition and earnings. For additional discussion of FNCB's competitive environment, refer to the section entitled "Business – Competition" included in Item 1 of this Annual Report on Form 10-K.

Changes in either FNCB's financial condition or in the general banking industry could result in a loss of depositor confidence.

Liquidity is the ability to meet cash flow needs on a timely basis at a reasonable cost. The Bank uses its liquidity to extend credit and to repay liabilities as they become due or as demanded by customers. The Board of Directors establishes liquidity policies, including contingency funding plans, and limits and management establishes operating guidelines for liquidity. FNCB's primary source of liquidity is customer deposits. The continued availability of this funding source depends on customer willingness to maintain deposit balances with banks in general and FNCB in particular. The availability of deposits can also be impacted by regulatory changes (e.g. changes in FDIC insurance, the liquidity coverage ratio, etc.), changes in the financial condition of FNCB, or the banking industry in general, and other events which can impact the perceived safety and soundness or economic benefits of bank deposits. While FNCB makes significant efforts to consider and plan for hypothetical disruptions in FNCB's deposit funding through the use of liquidity stress testing, market related, geopolitical, or other events could impact the liquidity derived from deposits.

FNCB may not be able to retain or grow its core deposit base, which could adversely impact its funding costs.

Like many financial institutions, FNCB relies on customer deposits as its primary source of funding for its lending activities, and FNCB continues to seek customer deposits to maintain this funding base. FNCB's future growth will largely depend on its ability to retain and grow its deposit base. As of December 31, 2018, FNCB had $1.096 billion in deposits. FNCB's deposits are subject to potentially dramatic fluctuations in availability or price due to certain factors outside of its control, such as increasing competitive pressures for deposits, changes in interest rates and returns on other investment classes, customer perceptions of its financial health and general reputation, and a loss of confidence by customers in FNCB or the banking sector generally, which could result in significant outflows of deposits within short periods of time or significant changes in pricing necessary to maintain current customer deposits or attract additional deposits. Any such loss of funds could result in lower loan originations, which could have a material adverse effect on FNCB's business, financial condition and results of operations.

FNCB is a bank holding company and depends on dividends from its subsidiary, FNCB Bank, to operate.

FNCB is an entity separate and distinct from the Bank. The Bank conducts most of FNCB's operations and FNCB depends upon dividends from the Bank to service FNCB's debt, pay FNCB's expenses and to pay dividends to FNCB's shareholders. The availability of dividends from the Bank is limited by various statutes and regulations. It is possible, depending upon the financial condition including liquidity and capital adequacy of the Bank and other factors, that the Bank's regulators could limit the payment of dividends or other payments to FNCB by the Bank. In the event that the Bank was unable to pay dividends, FNCB in turn would likely have to reduce or stop paying dividends to its shareholders. Failure to pay dividends to FNCB shareholders could have a material adverse effect on the market price of FNCB's Common Stock. For additional information regarding dividend restrictions, refer to the section entitled "Regulatory Matters" included in Item 1 of this Annual Report on Form 10-K.

If FNCB loses access to wholesale funding sources, it may not be able to meet the cash flow requirements of its depositors, creditors, and borrowers, or have the operating cash needed to fund corporate expansion and other corporate activities.

Wholesale funding sources include brokered deposits, one-way CDARS and ICS deposits, federal funds lines of credit, securities sold under repurchase agreements, non-core deposits, and long-term debt. The Bank is also a member of the Federal Home Loan Bank of Pittsburgh, which provides members access to funding through advances collateralized with certain qualifying assets within the Bank's loan portfolio. In addition, FNCB's available-for-sale securities provide an additional source of liquidity. Disruptions in availability of wholesale funding can directly impact the liquidity of FNCB and the Bank. The inability to access capital markets funding sources as needed could adversely impact FNCB's financial condition, results of operations, cash flows, and level of regulatory-qualifying capital.

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Interruptions or security breaches of FNCB's information systems could negatively affect its financial performance or reputation.

In conducting its business, FNCB relies heavily on its information systems. FNCB collects and stores sensitive data, including proprietary business information and personally identifiable information of its customers and employees, in its data centers and on its networks. The secure processing, maintenance and transmission of this information is critical to FNCB's operations and business strategy. Maintaining and protecting those systems is difficult and expensive, as is dealing with any failure, interruption or breach of those systems. Despite security measures, FNCB's information technology and infrastructure may be vulnerable to security breaches, cyber-attacks by hackers or breaches due to employee error, malfeasance or other disruptions. Any damage, failure or breach could cause an interruption in operations. Computer break-ins, phishing and other disruptions could also jeopardize the security of information stored in and transmitted through FNCB's computer systems and network infrastructure. The occurrence of any failures, interruptions or breaches could damage FNCB's reputation, disrupt operations and the services provided to customers, cause a loss of confidence in the products and the services provided, cause FNCB to incur additional expenses, result in a loss of customer business and data, result in legal claims or proceedings, result in liability under laws that protect the privacy of personal information, result in regulatory penalties, or expose FNCB to other liability, any of which could have a material adverse effect on its business, financial condition and results of operations and competitive position.

FNCB depends on information technology and telecommunications systems of third parties, and any systems failures or interruptions could adversely affect FNCB's operations and financial condition.

FNCB's business depends on the successful and uninterrupted functioning of its information technology and telecommunications systems. FNCB outsources many of its major systems, such as data processing, deposit processing, loan origination, email and anti-money laundering monitoring systems. The failure of these systems, or the termination of a third party software license or service agreement on which any of these systems is based, could interrupt FNCB's operations, and FNCB could experience difficulty in implementing replacement solutions. In many cases, FNCB's operations rely heavily on secured processing, storage and transmission of information and the monitoring of a large number of transactions on a minute-by-minute basis, and even a short interruption in service could have significant consequences. Because FNCB's information technology and telecommunications systems interface with and depend on third party systems, FNCB could experience service denials if demand for such services exceeds capacity or such third party systems fail or experience interruptions. If significant, sustained or repeated, a system failure or service denial could compromise FNCB's ability to operate effectively, damage FNCB's reputation, result in a loss of customer business and subject FNCB to additional regulatory scrutiny and possible financial liability, any of which could have a material adverse effect on FNCB's business, financial condition and results of operations. In addition, failure of third parties to comply with applicable laws and regulations, or fraud or misconduct on the part of employees of any of these third parties, could disrupt FNCB's operations or adversely affect FNCB's reputation.

FNCB is subject to cybersecurity risks and security breaches and may incur increasing costs in an effort to minimize those risks and to respond to cyber incidents, and FNCB may experience harm to its reputation and liability exposure from security breaches.*

FNCB's business involves the storage and transmission of customers' proprietary information and security breaches could expose FNCB to a risk of loss or misuse of this information, litigation and potential liability. While FNCB has not incurred a material cyber-attacks or security breaches to date, a number of other financial services and other companies have disclosed cyber-attacks and security breaches, some of which have involved intentional attacks. Attacks may be targeted at FNCB, its customers or both. Although FNCB devotes significant resources to maintain, regularly update and backup its systems and processes that are designed to protect the security of FNCB's computer systems, software, networks and other technology assets and the confidentiality, integrity and availability of information belonging to FNCB or its customers, its security measures may not be effective against all potential cyber-attacks or security breaches. Despite FNCB's efforts to ensure the integrity of its systems, it is possible that FNCB may not be able to anticipate, or implement effective preventive measures against, all security breaches of these types, especially because the techniques used change frequently or are not recognized until launched, and because cyber-attacks can originate from a wide variety of sources, including persons who are involved with organized crime or associated with external service providers or who may be linked to terrorist organizations or hostile foreign governments. These risks may increase in the future as FNCB continues to increase FNCB's internet-based product offerings and expand its internal usage of web-based products and applications. If an actual or perceived security breach occurs, customer perception of the effectiveness of FNCB's security measures could be harmed and could result in the loss of customers.

A successful penetration or circumvention of the security of FNCB's systems, including those of third party providers or other financial institutions, or the failure to meet regulatory requirements for security of its systems, could cause serious negative consequences, including significant disruption of FNCB's operations, misappropriation of FNCB's confidential information or that of FNCB's customers, or damage to FNCB's computers or systems or those of FNCB's customers or counterparties, significant increases in compliance costs (such as repairing systems or adding new personnel or protection technologies), and could result in violations of applicable privacy and other laws, financial loss to FNCB or to its customers, loss of confidence in its security measures, customer dissatisfaction, significant litigation and regulatory exposure, and harm to FNCB's reputation, all of which could have a material adverse effect on FNCB's business, financial condition and results of operations.

If FNCB's information technology is unable to keep pace with growth or industry developments or if technological developments result in higher costs or less advantageous pricing, financial performance may suffer.

Effective and competitive delivery of FNCB's products and services increasingly depends on information technology resources and processes, both those provided internally as well as those provided through third party vendors. In addition to better serving customers, the effective use of technology can improve efficiency and help reduce costs. FNCB's future success will depend, in part, upon its ability to address the needs of its customers by using technology to provide products and services to enhance customer convenience, as well as to create efficiencies in its operations. There is increasing pressure to provide products and services at lower prices. This can reduce net interest income and non-interest income from fee-based products and services. In addition, the widespread adoption of new technologies could require FNCB to make substantial capital expenditures to modify or adapt existing products and services or develop new products and services. FNCB may not be successful in introducing new products and services in response to industry trends or developments in technology, or those new products may not achieve market acceptance. Many of FNCB's competitors have greater resources to invest in technological improvements. Additionally, as technology in the financial services industry changes and evolves, keeping pace becomes increasingly complex and expensive. There can be no assurance that FNCB will be able to effectively implement new technology-driven products and services, which could reduce its ability to compete effectively. As a result, FNCB could lose business, be forced to price products and services on less advantageous terms to retain or attract customers, or be subject to cost increases.

FNCB relies on management and other key personnel and the loss of any of them may adversely affect its operations.

FNCB believes each member of the executive management team is important to its success and the unexpected loss of any of these persons could impair day-to-day operations as well as its strategic direction.

FNCB's success depends, in large part, on its ability to attract and retain key people. Competition for the best people in most activities engaged in by FNCB can be intense and it may not be able to hire people or retain them. The unexpected loss of services of one or more of FNCB's key personnel could have a material adverse impact on its business due to the loss of their skills, knowledge of its market, years of industry experience and to the difficulty of promptly finding qualified replacement personnel.

FNCB is dependent on the use of data and modeling in both its management's decision-making generally and in meeting regulatory expectations in particular.

The use of statistical and quantitative models and other quantitatively-based analyses is endemic to bank decision-making and regulatory compliance processes, and the employment of such analyses is becoming increasingly widespread in FNCB's operations. Liquidity stress testing, interest rate sensitivity analysis, allowance for loan loss measurement, portfolio stress testing and the identification of possible violations of anti-money laundering regulations are examples of areas in which FNCB is dependent on models and the data that underlies them. FNCB anticipates that model-derived insights will be used more widely in FNCB's decision-making in the future. While these quantitative techniques and approaches improve FNCB's decision-making, they also create the possibility that faulty data or flawed quantitative approaches could yield adverse outcomes or regulatory scrutiny. Secondarily, because of the complexity inherent in these approaches, misunderstanding or misuse of their outputs could similarly result in suboptimal decision making, which could have a material adverse effect on FNCB's business, financial condition and results of operations.

New lines of business, products, product enhancements or services may subject FNCB to additional risk.

From time to time, FNCB may implement new lines of business or offer new products and product enhancements as well as new services within FNCB's existing lines of business. There are substantial risks and uncertainties associated with these efforts. In developing, implementing or marketing new lines of business, products, product enhancements or services, FNCB may invest significant time and resources. FNCB may underestimate the appropriate level of resources or expertise necessary to make new lines of business or products successful to realize their expected benefits. FNCB may not achieve the milestones set in initial timetables for the development and introduction of new lines of business, products, product enhancements or services, and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives and shifting market preferences, may also impact the ultimate implementation of a new line of business or offering of new products, product enhancements or services. Any new line of business, product, product enhancement or service could have a significant impact on the effectiveness of FNCB's system of internal controls. FNCB may also decide to discontinue business or products, due to lack of customer acceptance or unprofitability. Failure to successfully manage these risks in the development and implementation of new lines of business or offerings of new products, product enhancements or services could have a material adverse effect on FNCB's business, financial condition and results of operations.

The appraisals and other valuation techniques FNCB uses in evaluating and monitoring loans secured by real property and other real estate owned may not accurately reflect the net value of the asset.

In considering whether to make a loan secured by real property, FNCB generally requires an appraisal of the property. However, an appraisal is only an estimate of the value of the property at the time the appraisal is made, and, as real estate values may change significantly in relatively short periods of time (especially in periods of heightened economic uncertainty), this estimate may not accurately reflect the net value of the collateral after the loan is made. As a result, FNCB may not be able to realize the full amount of any remaining indebtedness when FNCB forecloses on and sells the relevant property. In addition, FNCB relies on appraisals and other valuation techniques to establish the value of other real estate owned ("OREO"), that FNCB acquires through foreclosure proceedings and to determine loan impairments. If any of these valuations are inaccurate, FNCB's financial statements may not reflect the correct value of FNCB's OREO, if any, and FNCB's allowance for loan losses may not reflect accurate loan impairments. Inaccurate valuation of OREO or inaccurate provisioning for loan losses could have a material adverse effect on FNCB's business, financial condition and results of operations.

FNCB may be adversely affected by the soundness of other financial institutions.

FNCB's ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services companies are interrelated as a result of trading, clearing, counterparty and other relationships. As a result, defaults by, or even rumors or questions about, one or more financial services companies, or the financial services industry generally, could lead to market-wide liquidity problems and losses or defaults by FNCB or other institutions. These losses could have a material adverse effect on FNCB's business, financial condition and results of operations.

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Damage to FNCB's reputation could significantly harm its businesses, competitive position and prospects for growth.

FNCB's ability to attract and retain investors, customers, clients, and employees could be adversely affected by damage to its reputation resulting from various sources, including employee misconduct, litigation, or regulatory outcomes; failure to deliver minimum standards of service and quality; compliance failures; unethical behavior; unintended breach of confidential information; and the activities of FNCB's clients, customers, or counterparties. Actions by the financial services industry in general, or by certain entities or individuals within it, also could have a significantly adverse impact on FNCB's reputation.

FNCB's actual or perceived failure to identify and address various issues, including failure to properly address operational risks, could also give rise to reputational risk that could negatively impact business prospects. These issues include legal and regulatory requirements; consumer protection, fair lending, and privacy issues; properly maintaining customer and associated personal information; record keeping; protecting against money laundering; sales and trading practices; and ethical issues.

FNCB may be a defendant from time to time in a variety of litigation and other actions, which could have a material adverse effect on its financial condition, results of operations and cash flows.

FNCB has been and may continue to be involved from time to time in a variety of litigation matters arising out of its business. An increased number of lawsuits, including purported class action lawsuits and other consumer driven litigation, have been filed and will likely continue to be filed against financial institutions, which may involve substantial compensatory and/or punitive damages. Management believes the risk of litigation generally increases during downturns in the national and local economies. FNCB's insurance may not cover all claims that may be asserted against it, and any claims asserted against it, regardless of merit or eventual outcome, may harm its reputation and may cause it to incur significant expense. Should the ultimate judgments or settlements in any litigation exceed insurance coverage, they could have a material adverse effect on its financial condition, results of operations and cash flows. In addition, FNCB may not be able to obtain appropriate types or levels of insurance in the future, nor may it be able to obtain adequate replacement policies with acceptable terms, if at all. For additional discussion of FNCB's current legal matters, refer to Item 3, "Legal Proceedings" of this Annual Report on Form 10-K.

FNCB depends on the accuracy and completeness of information about customers and counterparties.

In deciding whether to extend credit or enter into other transactions with customers and counterparties, FNCB may rely on information furnished by or on behalf of customers and counterparties, including financial information. FNCB may also rely on representations of customers and counterparties as to the accuracy and completeness of that information. In deciding whether to extend credit, FNCB may rely upon customers' representations that their financial statements conform to GAAP and present fairly, in all material respects, the financial condition, results of operations and cash flows of the customer. FNCB also may rely on customer representations and certifications, or audit or accountants' reports, with respect to the business and financial condition of its customers. FNCB’s financial condition, results of operations, financial reporting and reputation could be negatively affected if FNCB relies on materially misleading, false, inaccurate or fraudulent information.

FNCB may face risks with respect to future expansion or acquisition activity.

FNCB may selectively seek to expand its banking operations through limited *de novo* branching or opportunistic acquisition activities. FNCB cannot be certain that any expansion activity, through *de novo* branching, acquisition of branches of another financial institution or a whole institution, or the establishment or acquisition of nonbanking financial service companies, will prove profitable or will increase shareholder value. The success of any acquisition will depend, in part, on FNCB’s ability to realize the estimated cost savings and revenue enhancements from combining its business and that of the target company. FNCB’s ability to realize increases in revenue will depend, in part, on its ability to retain customers and employees, and to capitalize on existing relationships for the provision of additional products and services. If FNCB estimates turn out to be incorrect or FNCB is not able to successfully combine companies, the anticipated cost savings and increased revenues may not be realized fully or at all, or may take longer to realize than expected. It is possible that the integration process could result in the loss of key employees, the disruption of each company’s ongoing business, diversion of management attention, or inconsistencies in standards, controls, procedures and policies that adversely affect FNCB’s ability to maintain relationships with clients and employees or to achieve the anticipated benefits of the merger. As with any combination of banking institutions, there also may be disruptions that cause FNCB to lose customers or cause customers to withdraw their deposits. Customers may not readily accept changes to their banking arrangements that FNCB makes as part of, or following, an acquisition. Additionally, the value of an acquisition to FNCB is dependent on its ability to successfully identify and estimate the magnitude of any asset quality issues of acquired companies.

FNCB may not be successful in overcoming these risks or other problems encountered in connection with potential acquisitions or other expansion activity. FNCB’s inability to overcome these risks could have an adverse effect on FNCB’s ability to implement its business strategy and enhance shareholder value, which, in turn, could have a material adverse effect on FNCB’s business, financial condition or results of operations. Additionally, if FNCB records goodwill in connection with any acquisition, FNCB’s financial condition and results of operation may be adversely affected if that goodwill is determined to be impaired, which would require FNCB to take an impairment charge.

FNCB could be subject to environmental risks and associated costs on its foreclosed real estate assets.

A substantial portion of FNCB’s loan portfolio is secured by real property. During the ordinary course of business, FNCB may foreclose on and take title to properties securing loans. There is a risk that hazardous or toxic substances could be found on these properties and that FNCB could be liable for remediation costs, as well as personal injury and property damage. Environmental laws may require FNCB to incur substantial expenses and may materially reduce the affected property's value or limit FNCB’s ability to sell the affected property. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on FNCB's business, financial condition and results of operations.

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Risks Related to FNCB's Industry

Federal and state regulators periodically examine FNCB's business and may require FNCB to remediate adverse examination findings or may take enforcement action against FNCB.

The Federal Reserve, the Federal Deposit Insurance Corporation ("FDIC") and the Pennsylvania Department of Banking and Securities ("PDBS"), periodically examine FNCB's business, including its compliance with laws and regulations. If, as a result of an examination, the Federal Reserve, FDIC or PDBS were to determine that FNCB's financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of any of FNCB's operations had become unsatisfactory, or that FNCB were in violation of any law or regulation, they may take a number of different remedial actions as they deem appropriate. These actions include the power to require FNCB to remediate any such adverse examination findings.

In addition, these agencies have the power to take enforcement action against FNCB to enjoin "unsafe or unsound" practices, to require affirmative action to correct any conditions resulting from any violation of law or regulation or unsafe or unsound practice, to issue an administrative order that can be judicially enforced, to direct an increase in FNCB's capital, to direct the sale of subsidiaries or other assets, to limit dividends and distributions, to restrict FNCB's growth, to assess civil money penalties against FNCB or its officers or directors, to remove officers and directors and, if it is concluded that such conditions cannot be corrected or there is imminent risk of loss to depositors, to terminate FNCB's deposit insurance and place the Bank into receivership or conservatorship. Any regulatory enforcement action against FNCB could have a material adverse effect on its business, financial condition and results of operations.

FNCB may be required to act as a source of financial and managerial strength for the Bank in times of stress.

FNCB, as a bank holding company, is required to act as a source of financial and managerial strength to the Bank and to commit resources to support the Bank if necessary. FNCB may be required to commit additional resources to the Bank at times when FNCB may not be in a financial position to provide such resources or when it may not be in FNCB's, or its shareholders' or creditors', best interests to do so. A requirement to provide such support is more likely during times of financial stress for FNCB and the Bank, which may make any capital FNCB is required to raise to provide such support more expensive than it might otherwise be. In addition, any capital loans FNCB makes to the Bank are subordinate in right of repayment to deposit liabilities of the Bank.

FNCB is subject to extensive government regulation, supervision and possible regulatory enforcement actions, which may subject it to higher costs and lower shareholder returns.

The banking industry is subject to extensive regulation and supervision that govern almost all aspects of its operations. The extensive regulatory framework is primarily intended to protect the federal deposit insurance fund and depositors, not shareholders. Compliance with applicable laws and regulations can be difficult and costly and, in some instances, may put banks at a competitive disadvantage compared to less regulated competitors such as finance companies, mortgage banking companies, leasing companies and internet-based Fintech companies. FNCB’s regulatory authorities have extensive discretion in their supervisory and enforcement activities, including with respect to the imposition of restrictions on the operation of a bank or a bank holding company, the imposition of significant fines, the ability to delay or deny merger or other regulatory applications, the classification of assets by a bank, and the adequacy of a bank’s allowance for loan losses, among other matters. If they deem FNCB to be operating in a manner inconsistent with safe and sound banking practices, these regulatory authorities can require the entry into informal and formal supervisory agreements, including board resolutions, memoranda of understanding, settlement agreements and consent or cease and desist orders, pursuant to which FNCB would be required to implement identified corrective actions to address cited concerns and/or to refrain from taking certain actions in the form of injunctive relief. In recent years, the banking industry has faced increased regulation and scrutiny; for instance, areas such as BSA compliance (including BSA and related anti-money laundering regulations) and real estate-secured consumer lending (such as Truth-in-Lending regulations, changes in Real Estate Settlement Procedures Act regulations, implementation of licensing and registration requirements for mortgage originators and more recently, heightened regulatory attention to mortgage and foreclosure-related activities and exposures) are being confronted with escalating regulatory expectations and scrutiny. Non-compliance with laws and regulations such as these, even in cases of inadvertent non-compliance, could result in litigation, significant fines and/or sanctions. Any failure to comply with, or any change in, any applicable regulation and supervisory requirement, or change in regulation or enforcement by such authorities, whether in the form of policies, regulations, legislation, rules, orders, enforcement actions, or decisions, could have a material impact on FNCB, the Bank and other affiliates, and its operations. Federal economic and monetary policy may also affect FNCB’s ability to attract deposits and other funding sources, make loans and investments, and achieve satisfactory interest spreads. Any failure to comply with such regulation or supervision could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on FNCB’s business, financial condition and results of operations. In addition, compliance with any such action could distract management’s attention from FNCB’s operations, cause it to incur significant expenses, restrict it from engaging in potentially profitable activities and limit its ability to raise capital.

New or changed legislation or regulation and regulatory initiatives could adversely affect FNCB through increased regulation and increased costs of doing business.

Changes in federal and state legislation and regulation may affect FNCB’s operations. New and modified regulations, such as the Dodd-Frank Act and Basel III, may have unforeseen or unintended consequences on the banking industry. The Dodd-Frank Act has implemented significant changes to the U.S. financial system, including the creation of new regulatory agencies (such as the Financial Stability Oversight Council to oversee systemic risk and the CFPB to develop and enforce rules for consumer financial products), changes in retail banking regulations, and changes to deposit insurance assessments. For example, the Dodd-Frank Act has implemented new requirements with respect to “qualified mortgages” and new mortgage servicing standards have, and may continue to, increase costs associated with this business. For a more detailed description, see the section entitled “Business – The Bank – *Consumer Financial Protection Bureau*” included in Item 1 to this Annual Report on Form 10-K.

Additionally, final rules to implement Basel III adopted in July 2013 revise risk-based and leverage capital requirements and limit capital distributions and certain discretionary bonuses if a banking organization does not hold the required “capital conservation buffer.” The rule became effective for FNCB on January 1, 2015, with some additional transition periods. This additional regulation could increase compliance costs and otherwise adversely affect operations. For a more detailed description of the final rules, see the description in Item 1 of this Annual Report on Form 10-K under the heading “Capital Adequacy Requirements”. The potential also exists for additional federal or state laws or regulations, or changes in policy or interpretations, affecting many of FNCB’s operations, including capital levels, lending and funding practices, insurance assessments, and liquidity standards. The effect of any such changes and their interpretation and application by regulatory authorities cannot be predicted, may increase FNCB’s cost of doing business and otherwise affect FNCB’s operations, may significantly affect the markets in which it does business, and could have a materially adverse effect on FNCB.

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FNCB is also subject to the guidelines under the GLB Act. The GLB Act guidelines require, among other things, that each financial institution develop, implement and maintain a written, comprehensive information security program containing safeguards that are appropriate to the financial institution's size and complexity, the nature and scope of the financial institution's activities and the sensitivity of any customer information at issue. In recent years there also has been increasing enforcement activity in the areas of privacy, information security and data protection in the United States, including at the federal level. Compliance with these laws, rules and regulations regarding the privacy, security and protection of customer and employee data could result in higher compliance and technology costs. In addition, non-compliance could result in potentially significant fines, penalties and damage to FNCB's reputation and brand.

The Federal Reserve may also set higher capital requirements for holding companies whose circumstances warrant it. For example, holding companies experiencing significant internal growth or making acquisitions are expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets. FNCB's regulatory capital ratios currently are in excess of the levels established for "well capitalized" institutions. Future regulatory change could impose higher capital standards.

Section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (the "Regulatory Relief Act") directed the federal banking agencies to develop a community bank leverage ratio ("CBLR"), of not less that 8% and not more than 10% for qualifying community banks and bank holding companies with total consolidated assets of less than $10 billion. Qualifying community banking organizations that exceed the CBLR level established by the agencies, and that elect to be covered by the CBLR framework, will be considered to have met: (i) the generally applicable leverage and risk-based capital requirements under the banking agencies' capital rules; (ii) the capital ratio requirements necessary to be considered "well capitalized" under the banking agencies' prompt corrective action framework in the case of insured depository institutions; and (iii) any other applicable capital or leverage requirements. If we qualify for this simplified capital regime, there can be no assurance that satisfaction of the CBLR will provide adequate capital for our operations and growth, or an adequate cushion against increase levels of nonperforming assets or weakened economic conditions

Any new or revised standards adopted in the future may require us to maintain materially more capital, with common equity as a more predominant component, or manage the configuration of our assets and liabilities to comply with formulaic liquidity requirements. We may not be able to raise additional capital at all, or on terms acceptable to us. Failure to maintain capital to meet current or future regulatory requirements could have a significant material adverse effect on our business, financial condition and results of operations.]

FNCB faces a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.

The Bank Secrecy Act of 1970, the Uniting and Strengthening America by Providing Appropriate Tools to Intercept and Obstruct Terrorism Act of 2001, or the USA Patriot Act or Patriot Act, and other laws and regulations require financial institutions, among other duties, to institute and maintain an effective anti-money laundering program and to file reports such as suspicious activity reports and currency transaction reports. FNCB is required to comply with these and other anti-money laundering requirements. FNCB’s federal and state banking regulators, the Financial Crimes Enforcement Network (“FinCEN”), and other government agencies are authorized to impose significant civil money penalties for violations of anti-money laundering requirements. FNCB is also subject to increased scrutiny of compliance with the regulations issued and enforced by the Office of Foreign Assets Control (“OFAC”). If FNCB’s program is deemed deficient, FNCB could be subject to liability, including fines, civil money penalties and other regulatory actions, which may include restrictions on FNCB’s business operations and its ability to pay dividends, restrictions on mergers and acquisitions activity, restrictions on expansion, and restrictions on entering new business lines. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have significant reputational consequences for FNCB. Any of these circumstances could have a material adverse effect on FNCB’s business, financial condition or results of operations.

FNCB is subject to numerous "fair and responsible banking" laws designed to protect consumers, and failure to comply with these laws could lead to a wide variety of sanctions.

The Community Reinvestment Act, the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations, including state laws and regulations, prohibit discriminatory lending practices by financial institutions. The Federal Trade Commission Act and the Dodd-Frank Act prohibit unfair, deceptive, or abusive acts or practices by financial institutions. The U.S. Department of Justice, or DOJ, federal banking agencies, and other federal and state agencies are responsible for enforcing these fair and responsible banking laws and regulations. A challenge to an institution’s compliance with fair and responsible banking laws and regulations could result in a wide variety of sanctions, including damages and civil money penalties, injunctive relief, restrictions on mergers and acquisitions activity, restrictions on expansion and restrictions on entering new business lines. Private parties may also have the ability to challenge an institution’s performance under fair lending laws in private class action litigation. Such actions could have a material adverse effect on FNCB’s reputation, business, financial condition and results of operations.

FNCB is subject to laws regarding the privacy, information security and protection of personal information and any violation of these laws or another incident involving personal, confidential or proprietary information of individuals could damage FNCB’s reputation and otherwise adversely affect FNCB’s business.

FNCB’s business requires the collection and retention of large volumes of customer data, including personally identifiable information (“PII”), in various information systems that FNCB maintains and in those maintained by third party service providers. FNCB also maintains important internal company data such as PII about its employees and information relating to its operations. FNCB is subject to complex and evolving laws and regulations governing the privacy and protection of PII of individuals (including customers, employees and other third parties). For example, FNCB’s business is subject to the Gramm-Leach-Bliley Act, or the GLB Act, which, among other things: (i) imposes certain limitations on FNCB’s ability to share nonpublic PII about FNCB’s customers with nonaffiliated third parties; (ii) requires that FNCB provides certain disclosures to customers about its information collection, sharing and security practices and afford customers the right to "opt out" of any information sharing by FNCB with nonaffiliated third parties (with certain exceptions); and (iii) requires that FNCB develops, implements and maintains a written comprehensive information security program containing appropriate safeguards based on FNCB’s size and complexity, the nature and scope of its activities, and the sensitivity of customer information FNCB processes, as well as plans for responding to data security breaches. Various federal and state banking regulators and states have also enacted data breach notification requirements with varying levels of individual, consumer, regulatory or law enforcement notification in the event of a security breach. Ensuring that FNCB's collection, use, transfer and storage of PII complies with all applicable laws and regulations can increase FNCB's costs. Furthermore, FNCB may not be able to ensure that customers and other third parties have appropriate controls in place to protect the confidentiality of the information that they exchange with FNCB, particularly where such information is transmitted by electronic means. If personal, confidential or proprietary information of customers or others were to be mishandled or misused (in situations where, for example, such information was erroneously provided to parties who are not permitted to have the information, or where such information was intercepted or otherwise compromised by third parties), FNCB could be exposed to litigation or regulatory sanctions under privacy and data protection laws and regulations. Concerns regarding the effectiveness of FNCB's measures to safeguard PII, or even the perception that such measures are inadequate, could cause FNCB to lose customers or potential customers and thereby reduce FNCB's revenues. Accordingly, any failure, or perceived failure, to comply with applicable privacy or data protection laws and regulations may subject FNCB to inquiries, examinations and investigations that could result in requirements to modify or cease certain operations or practices or in significant liabilities, fines or penalties, and could damage FNCB's reputation and otherwise adversely affect FNCB's operations, financial condition and results of operations.

Rulemaking changes implemented by the Consumer Financial Protection Bureau may result in higher regulatory and compliance costs that may adversely affect FNCB's business.

The Dodd-Frank Act created a new, independent federal agency, the Consumer Financial Protection Bureau, or CFPB, which was granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws. The consumer protection provisions of the Dodd-Frank Act and the examination, supervision and enforcement of those laws and implementing regulations issued by the CFPB have created a more intense and complex environment for consumer finance regulation. The ultimate impact of this heightened scrutiny is uncertain but could result in changes to pricing, practices, products and procedures. It could also result in increased costs related to regulatory oversight, supervision and examination. These changes could have a material adverse effect on FNCB's business, financial condition and results of operations.

Potential limitations on incentive compensation contained in proposed federal agency rulemaking may adversely affect FNCB's ability to attract and retain its highest performing employees.

The Federal Reserve, other federal banking agencies and the SEC have jointly published proposed rules designed to implement provisions of the Dodd-Frank Act prohibiting incentive compensation arrangements that would encourage inappropriate risk taking at covered financial institutions, which includes a bank or bank holding company with $1 billion or more in consolidated assets. It cannot be determined at this time whether or when a final rule will be adopted and whether compliance with such a final rule will substantially affect the manner in which FNCB structures compensation for its executives and other employees. Depending on the nature and application of the final rules, FNCB may not be able to successfully compete with financial institutions and other companies that are not subject to some or all of the rules to retain and attract executives and other high performing employees.

The Bank's FDIC deposit insurance premiums and assessments may increase.

The Bank's deposits are insured by the FDIC up to legal limits and, accordingly, the Bank is subject to insurance assessments based on the Bank's average consolidated total assets less its average tangible equity. The Bank's regular assessments are determined by its risk classification, which is based on its regulatory capital levels and the level of supervisory concern that it poses. Numerous bank failures during the financial crisis and increases in the statutory deposit insurance limits increased resolution costs to the FDIC and put significant pressure on the Deposit Insurance Fund. In order to maintain a strong funding position and the reserve ratios of the Deposit Insurance Fund required by statute and FDIC estimates of projected requirements, the FDIC has the power to increase deposit insurance assessment rates and impose special assessments on all FDIC-insured financial institutions. Any future increases or special assessments could reduce FNCB's profitability and could have a material adverse effect on FNCB's business, financial condition and results of operations.

Risks Related to FNCB's Common Stock

The price of FNCB's common stock may fluctuate significantly, which may make it difficult for shareholders to resell shares of common stock at a time or price they find attractive.

FNCB's stock price may fluctuate significantly as a result of a variety of factors, many of which are beyond its control. These factors include, among others:

- actual or anticipated quarterly fluctuations in operating results and financial condition;
- changes in financial estimates or publication of research reports and recommendations by financial analysts or actions taken by rating agencies with respect to FNCB or other financial institutions;
- speculation in the press or investment community generally or relating to FNCB's reputation or the financial services industry;
- failure to declare dividends on FNCB's common stock from time to time;
- failure to meet analysts' revenue or earnings estimates;
- failure to integrate any future acquisitions or realize anticipated benefits from any future acquisitions;
- strategic actions by FNCB or its competitors, such as acquisitions, restructurings, dispositions or financings;
- fluctuations in the stock price and operating results of FNCB's competitors or other companies that investors deem comparable to FNCB;
- future sales of FNCB's equity or equity-related securities;
- proposed or adopted regulatory changes or developments;
- anticipated or pending audits or litigation that involve or affect FNCB;
- any future investigations or proceedings that involve or affect FNCB;
- adverse weather conditions, including floods, tornadoes and hurricanes;
- geopolitical conditions such as acts or threats of terrorism or military conflicts;
- domestic and international economic factors unrelated to FNCB's performance; and
- general market conditions and, in particular, developments related to market conditions for the financial services industry.

In addition, in recent years, the stock market in general has experienced extreme price and volume fluctuations. This volatility has had a significant effect on the market price of securities issued by many companies, including for reasons unrelated to their operating performance. These broad market fluctuations may adversely affect FNCB's stock price, notwithstanding its operating results. FNCB expects that the market price of its common stock will continue to fluctuate and there can be no assurances about the levels of the market prices for its common stock.

General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, could also cause FNCB's stock price to decrease regardless of operating results.

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An active public market for FNCB's common stock does not currently exist. As a result, shareholders may not be able to quickly and easily sell their shares of common stock.

Until March 5, 2018, FNCB's shares of common stock were quoted on the OTCQX. An average of 5,669 shares of FNCB's common stock traded on the OTCQX during 2017 on a daily basis. On March 5, 2018, FNCB's shares of common stock began trading on The Nasdaq Capital Market®. An active, liquid market for FNCB's shares of common stock has not previously existed, and there can be no assurance that an active and liquid market will develop, or if one does develop, if it can be maintained. The absence of an active trading market may make it difficult for FNCB shareholders to sell FNCB's shares of common stock at the prevailing price when desired or at all, particularly in large quantities. For a further discussion, see Item 5, "Market for Registrant's Common Equity, Related Shareholder Matters, and Issuer Purchases of Equity Securities" to this Annual Report on Form 10-K.

The rights of holders of FNCB's common stock to receive liquidation payments and dividend payments are junior to FNCB's existing and future indebtedness and to any senior securities FNCB may issue in the future, and FNCB's ability to declare dividends on the common stock may become limited.

Shares of the common stock are equity interests in FNCB and do not constitute indebtedness. As such, shares of FNCB's common stock rank junior to all current and future indebtedness and other non-equity claims on FNCB with respect to assets available to satisfy claims on FNCB, including in a liquidation of FNCB. FNCB may, and the Bank and FNCB's other subsidiaries may also, incur additional indebtedness from time to time and may increase FNCB's aggregate level of outstanding indebtedness.

FNCB's board of directors is authorized to cause FNCB to issue additional classes or series of preferred stock without any action on the part of the shareholders. If FNCB issues preferred shares in the future that have a preference over its common stock with respect to the payment of dividends or upon liquidation, or if FNCB issues preferred shares with voting rights that dilute the voting power of the common stock, then the rights of holders of FNCB's common stock or the market price of FNCB's common stock could be adversely affected.

FNCB's ability to pay dividends may become limited by regulatory restrictions. In addition, the ability of the Bank to pay dividends to FNCB is limited by the Bank's obligations to maintain sufficient accumulated net earnings and by other general restrictions on dividends that are applicable to state nonmember banks.

Holders of FNCB's common stock are only entitled to receive the dividends that FNCB's board of directors may declare out of funds legally available for those payments. Although FNCB has historically paid cash dividends on its common stock, FNCB is not required to do so. FNCB cannot assure shareholders that it will continue paying dividends in the future. This could adversely affect the market price of FNCB's common stock. Also, as discussed above, FNCB is a bank holding company and its ability to declare and pay dividends depends in part on federal regulatory considerations, including the guidelines of the Federal Reserve regarding capital adequacy and dividends.

FNCB may need to raise additional capital in the future, but that capital may not be available when it is needed and on terms favorable to current shareholders.

Laws, regulations and banking regulators require FNCB and the Bank to maintain adequate levels of capital to support their operations. In addition, capital levels are determined by FNCB's management and Board of Directors based on capital levels that they believe are necessary to support business operations. Management regularly evaluates its present and future capital requirements and needs and analyzes capital raising alternatives and options. Although FNCB succeeded in meeting its current regulatory capital requirements, it may need to raise additional capital in the future to support growth, possible loan losses or potential OTTI during future periods, to meet future regulatory capital requirements or for other reasons.

The Board of Directors may determine from time to time that FNCB needs to raise additional capital by issuing additional shares of common stock or other securities. FNCB is not restricted from issuing additional shares of common stock, including securities that are convertible into or exchangeable for, or that represent the right to receive, common stock. Because FNCB's decision to issue securities in any future offering will depend on market conditions and other factors beyond its control, FNCB cannot predict or estimate the amount, timing or nature of any future offerings, or the prices at which such offerings may be affected. Such offerings will likely be dilutive to common shareholders from ownership, earnings and book value perspectives. New investors also may have rights, preferences and privileges that are senior to, and that adversely affect, its then current common shareholders. Additionally, if FNCB raises additional capital by making additional offerings of debt or preferred equity securities, upon liquidation, holders of its debt securities and shares of preferred shares, and lenders with respect to other borrowings, will receive distributions of available assets prior to the holders of common stock. Additional equity offerings may dilute the holdings of existing shareholders or reduce the market price of FNCB's common stock, or both. Holders of FNCB's common stock are not entitled to preemptive rights or other protections against dilution.

FNCB cannot provide any assurance that additional capital will be available on acceptable terms or at all. Any occurrence that may limit access to the capital markets may adversely affect FNCB's capital costs and its ability to raise capital and, in turn, its liquidity. Moreover, if FNCB needs to raise capital, it may have to do so when many other financial institutions are also seeking to raise capital and would have to compete with those institutions for investors. An inability to raise additional capital on acceptable terms when needed could have a material adverse effect on FNCB's business, financial condition and results of operations.

An investment in FNCB's common stock is not an insured deposit.

FNCB's common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund or by any other public or private entity. Investment in FNCB's common stock is inherently risky for the reasons described in this "Risk Factors" section, and elsewhere in FNCB's reports filed with the SEC, including under heading "Risk Factors" in FNCB's most recently filed Annual Report on Form 10-K. Investment in FNCB's common stock is also subject to the market forces that affect the price of common stock in any company. As a result, shareholders may lose some or all of their investment in FNCB's common stock.

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Shareholders may not receive dividends on FNCB's common stock.

Although FNCB has historically declared quarterly cash dividends on its common stock, FNCB is not required to do so and may reduce or cease to pay common stock dividends in the future. If FNCB reduces or ceases to pay common stock dividends, the market price of its common stock could be adversely affected.

The principal source of funds from which FNCB pays cash dividends are the dividends received from the Bank. Banking laws and regulations of the Commonwealth of Pennsylvania restrict the amount of dividends and loans a bank may make to its parent company. In addition, under The Federal Deposit Insurance Corporation Improvement Act of 1991, banks may not pay a dividend if, after paying the dividend, the bank would be undercapitalized.

If FNCB fails to pay dividends, capital appreciation, if any, of its common stock may be the sole opportunity for gains on an investment in its common stock. In addition, in the event the Bank becomes unable to pay dividends to FNCB, FNCB may not be able to service its debt or pay its other obligations or pay dividends on its common stock and preferred stock. Accordingly, FNCB's inability to receive dividends from the Bank could also have a material adverse effect on its business, financial condition and results of operations and the value of a shareholder's investment in FNCB's common stock.

An entity holding as little as a 5% interest in FNCB's outstanding securities could, under certain circumstances, be subject to regulation as a "bank holding company."

Any entity, including a "group" composed of natural persons, owning or controlling with the power to vote 25% or more of FNCB's outstanding securities, or 5% or more if the holder otherwise exercises a "controlling influence" over FNCB, may be subject to regulation as a "bank holding company" in accordance with the Bank Holding Company Act of 1956, as amended, or the BHC Act. In addition, (a) any bank holding company or foreign bank with a U.S. presence may be required to obtain the approval of the Federal Reserve under the BHC Act to acquire or retain 5% or more of FNCB's outstanding securities and (b) any person not otherwise defined as a company by the BHC Act and its implementing regulations may be required to obtain the approval of the Federal Reserve under the Change in Bank Control Act to acquire or retain 10% or more of FNCB's outstanding securities. Becoming a bank holding company imposes statutory and regulatory restrictions and obligations, such as providing managerial and financial strength for its bank subsidiaries. Regulation as a bank holding company could require the holder to divest all or a portion of the holder's investment in FNCB's securities or those nonbanking investments that may be deemed impermissible or incompatible with bank holding company status, such as a material investment in a company unrelated to banking.

The requirements of being a public company may strain FNCB's resources and divert management's attention.

FNCB is a public company, subject to the reporting requirements of the Exchange Act, the Sarbanes-Oxley Act and applicable securities rules and regulations. Under FDIC regulations, the Sarbanes-Oxley Act and regulations increase the scope, complexity and cost of corporate governance, reporting and disclosure practices over those of non-public or non-reporting companies. Among other things, the Exchange Act requires that FNCB file annual, quarterly and current reports with respect to its business and operating results and maintain effective disclosure controls and procedures and internal control over financial reporting. As a Nasdaq listed company, FNCB is also required to prepare and file proxy materials which meet the requirements of the Exchange Act and the SEC's proxy rules. Compliance with these rules and regulations increase FNCB’s legal and financial compliance costs, make some activities more difficult, time-consuming or costly, and increase demand on FNCB’s systems and resources, particularly it FNCB becomes ineligible to report as a “smaller reporting company” as defined in the SEC’s regulations. In order to maintain, appropriately document and, if required, improve FNCB’s disclosure controls and procedures and internal control over financial reporting to meet the standards required by the Sarbanes-Oxley Act, significant resources and management oversight may be required. As a result, management's attention may be diverted from other business concerns, which could harm FNCB’s business and operating results. Additionally, any failure by FNCB to file its periodic reports with the SEC in a timely manner could, among other things, harm its reputation, cause its investors and potential investors to lose confidence in FNCB, restrict trading in or reduce the market price of FNCB’s common stock, and potentially limit its ability to access the capital markets.

As a public company, FNCB incurs significant legal, accounting, insurance, compliance and other expenses. Any deficiencies in FNCB’s financial reporting or internal controls could materially and adversely affect its business and the market price of FNCB’s common stock.

As a public company, FNCB incurs significant legal, accounting, insurance and other expenses. These costs and compliance with the rules of the SEC and the rules of Nasdaq increase FNCB’s legal and financial compliance costs and make some activities more time consuming and costly. SEC rules require that FNCB’s Chief Executive Officer and Chief Financial Officer periodically certify the existence and effectiveness of its internal control over financial reporting. In addition, FNCB is required to engage an independent registered public accounting firm to audit and opine on the design and operating effectiveness of its internal control over financial reporting. This process requires significant documentation of policies, procedures and systems, and review of that documentation and testing of FNCB’s internal control over financial reporting by its internal auditing and accounting staff and an independent registered public accounting firm. This process requires considerable time and attention from management, which could prevent FNCB from successfully implementing its business initiatives and improving its business, financial condition and results of operations, any strain FNCB’s internal resources, and will increase its operating costs. FNCB may experience higher than anticipated operating expenses and outside auditor fees during the implementation of these changes and thereafter.

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During the course of FNCB's testing it may identify deficiencies that would have to be remediated to satisfy the SEC rules for certification of FNCB's internal control over financial reporting. A material weakness is defined by the standards issued by the PCAOB as a deficiency, or combination of deficiencies, in internal control over financial reporting that results in a reasonable possibility that a material misstatement of FNCB's annual or interim financial statements will not be prevented or detected on a timely basis. As a consequence, FNCB would have to disclose in periodic reports it files with the SEC any material weakness in its internal control over financial reporting. The existence of a material weakness would preclude management from concluding that FNCB's internal control over financial reporting is effective and would preclude its independent auditors from expressing an unqualified opinion on the effectiveness of its internal control over financial reporting. In addition, disclosures of deficiencies of this type in FNCB's SEC reports could cause investors to lose confidence in its financial reporting, and may negatively affect the market price of its common stock, and could result in the delisting of its securities from the securities exchanges on which they trade. Moreover, effective internal controls are necessary to produce reliable financial reports and to prevent fraud. If FNCB has deficiencies in its disclosure controls and procedures or internal control over financial reporting, it may materially and adversely affect FNCB.

FNCB's disclosure controls and procedures and internal controls over financial reporting may not achieve their intended objectives.

FNCB maintains disclosure controls and procedures designed to ensure the timely filing of reports as specified in the rules and forms of the Securities and Exchange Commission. FNCB also maintains a system of internal control over financial reporting. These controls may not achieve their intended objectives. Control processes that involve human diligence and compliance, such as its disclosure controls and procedures and internal controls over financial reporting, are subject to lapses in judgment and breakdowns resulting from human failures. Controls can also be circumvented by collusion or improper management override. Because of such limitations, there are risks that material misstatements due to error or fraud may not be prevented or detected and that information may not be reported on a timely basis. If FNCB's controls are not effective, it could have a material adverse effect on its financial condition, results of operations, and market for its common stock, and could subject it to additional regulatory scrutiny.

Changes in accounting standards could impact reported earnings.

From time to time there are changes in the financial accounting and reporting standards that govern the preparation of financial statements. These changes can materially impact how FNCB records and reports its financial condition and results of operations. In some instances, FNCB could be required to apply a new or revised standard retroactively, resulting in the restatement of prior period financial statements.

Changes which have been approved for future implementation, or which are currently proposed or expected to be proposed or adopted include requirements that we: (i) calculate the allowance for loan losses on the basis of the current expected credit losses over the lifetime of our loans, referred to as the CECL model, which is expected to be applicable to us beginning in 2020; and (ii) record the value of and liabilities relating to operating leases on our balance sheet, which is expected to be applicable beginning in 2019. These changes could adversely affect our capital, regulatory capital ratios, ability to make larger loans, earnings and performance metrics. Any such changes could have a material adverse effect on our business, financial condition and results of operations.

Under the CECL model, banks will be required to present certain financial assets carried at amortized cost, such as loans held for investment and held-to-maturity debt securities, at the net amount expected to be collected. The measurement of expected credit losses is to be based on information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. This measurement will take place at the time the financial asset is first added to the balance sheet and periodically thereafter. This differs significantly from the "incurred loss" model required under current GAAP, which delays recognition until it is probable a loss has been incurred. Accordingly, we expect that the adoption of the CECL model will materially affect how we determine our allowance for loan losses, and could require us to significantly increase our allowance. Moreover, the CECL model may create more volatility in the level of the allowance for loan losses. If we are required to materially increase the level of the allowance for loan losses for any reason, such increase could adversely affect our business, financial condition and results of operations. We are evaluating the impact the CECL accounting model will have on our accounting, but expect to recognize a one-time cumulative-effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective. We cannot yet determine the magnitude of any such one-time cumulative adjustment or of the overall impact of the new standard on our financial condition or results of operations.

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Anti-takeover provisions in FNCB's charter documents could discourage, delay or prevent a change of control of FNCB's company and diminish the value of FNCB's common stock.

Some of the provisions of FNCB's amended and restated articles of incorporation, as amended, and amended and restated bylaws, as amended, could make it difficult for its shareholders to change the composition of its board of directors, preventing them from changing the composition of management. In addition, the same provisions may discourage, delay or prevent a merger or acquisition that FNCB's shareholders may consider favorable. These provisions include:

- classifying FNCB's board of directors into three classes of directors with staggered three-year terms;
- authorizing FNCB's board of directors to issue preferred shares without shareholder approval;
- prohibiting cumulative voting in the election of directors;
- requiring the approval of 75% of FNCB's shareholders to approve any merger or sale of all, or substantially all, unless approval of such proposed transaction is recommended by at least a majority of FNCB's entire board of directors;
- authorizing FNCB's board of directors to, if it deems advisable, oppose a tender or other offer for FNCB's securities; and
- requiring the approval of 75% of FNCB's shareholders to amend certain provisions relating to business combinations not approved by the board of directors.

In addition, pursuant to the Pennsylvania Business Corporation Law (the "PBCL"), in the case of a merger or share exchange, with some exceptions, FNCB's board of directors must submit the plan of merger or share exchange to the shareholders for approval, and the approval of the plan of merger or share exchange generally requires the approval of the shareholders at a meeting at which a quorum consisting of at least a majority of the shares entitled to vote on the plan exists.

Provisions of the PBCL, applicable to FNCB provide, among other things, that:

- FNCB may not engage in a business combination with an "interested shareholder," generally defined as a holder of 20% of a corporation's voting stock, during the five-year period after the interested shareholder became such except under certain specified circumstances;
- holders of FNCB's common stock may object to a "control transaction" involving FNCB (a control transaction is defined as the acquisition by a person or group of persons acting in concert of at least 20% of the outstanding voting stock of a corporation), and demand that they be paid a cash payment for the "fair value" of their shares from the "controlling person or group";
- holders of "control shares" will not be entitled to voting rights with respect to any shares in excess of specified thresholds, including 20% voting control, until the voting rights associated with such shares are restored by the affirmative vote of a majority of disinterested shares and the outstanding voting shares of the Company; and
- any "profit," as defined in the PBCL, realized by any person or group who is or was a "controlling person or group" with respect to FNCB from the disposition of any equity securities of within 18 months after the person or group became a

"controlling person or group" shall belong to and be recoverable by FNCB.

These anti-takeover provisions could impede the ability of FNCB's common shareholders to benefit from a change of control and, as a result, could have a material adverse effect on the market price of FNCB's common stock and shareholders' ability to realize any potential change-in-control premium.

Short sellers of FNCB's stock may be manipulative and may drive down the market price of FNCB's common stock.

Short selling is the practice of selling securities that the seller does not own but rather has borrowed or intends to borrow from a third party with the intention of buying identical securities at a later date to return to the lender. A short seller hopes to profit from a decline in the value of the securities between the sale of the borrowed securities and the purchase of the replacement shares, as the short seller expects to pay less in that purchase than it received in the sale. As it is in the short seller's interest for the price of the stock to decline, some short sellers publish, or arrange for the publication of, opinions or characterizations regarding the relevant issuer, its business practices and prospects and similar matters calculated to or which may create negative market momentum, which may permit them to obtain profits for themselves as a result of selling the stock short. Issuers whose securities have historically had limited trading volumes or have been susceptible to relatively high volatility levels can be particularly vulnerable to such short seller attacks. The publication of any such commentary regarding FNCB in the future may bring about a temporary, or possibly long-term, decline in the market price of FNCB's common stock. No assurances can be made that declines in the market price of FNCB's common stock will not occur in the future, in connection with such commentary by short sellers or otherwise. When the market price of a company's stock drops significantly, it is not unusual for stockholder lawsuits to be filed or threatened against the company and its board of directors and for a company to suffer reputational damage. Such lawsuits could cause FNCB to incur substantial costs and divert the time and attention of FNCB's board and management. In addition, reputational damage may affect FNCB's ability to attract and retain deposits and may cause FNCB's deposit costs to increase, which could adversely affect its liquidity and earnings. Reputational damage may also affect FNCB's ability to attract and retain loan customers and maintain and develop other business relationships, which could likewise adversely affect FNCB's earnings. Negative reports issued by short sellers could also negatively impact FNCB's ability to attract and retain employees.

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Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

FNCB currently conducts business from its headquarters, which also houses the Bank's main office, located at 102 East Drinker Street, Dunmore, Pennsylvania, 18512. At December 31, 2018, FNCB also operated fifteen additional branches located throughout Lackawanna, Luzerne and Wayne counties, an LPO located in Allentown, Lehigh County, Pennsylvania and a lending center and two administrative offices located in Dunmore, Lackawanna County, Pennsylvania. Ten of the offices are leased and the balance are owned by the Bank. Except for potential remodeling of certain facilities to provide for the efficient use of work space and/or to maintain an appropriate appearance, each property is considered reasonably suitable and adequate for current and immediate future purposes except as discussed below.

As part of its responsibilities, management regularly evaluates FNCB's delivery system and facilities including analyzing each office's operating efficiency, location, foot traffic, structure and design. As a result of these evaluations, in 2017, FNCB and the Bank implemented a comprehensive branch network improvement program that focuses on strengthening, better positioning and expanding its market coverage by developing new state-of-the-art customer facilities, as well as relocating and consolidating select locations. Initiatives FNCB executed under the branch network improvement program include:

On January 20, 2017, FNCB opened a LPO in Allentown, Lehigh County, Pennsylvania and began offering its retail and commercial lending products in this new market area. This LPO is located in an office leased by the Bank at 3500 Winchester Road, Suites 101 and 102, Allentown, Pennsylvania, 18104.

On June 30, 2017, FNCB consolidated its Honesdale Route 6 branch office located at 1127 Texas Palmyra Highway, Honesdale, Wayne County, Pennsylvania with its branch located at 1001 Main Street, Honesdale, Pennsylvania. The Honesdale Route 6 property is under an operating lease agreement that expires in 2022. FNCB continued to operate the Honesdale Route 6 location as a remote ATM location for the remainder of 2017 and the majority of 2018. In the fourth quarter of 2018, FNCB ceased operating this ATM location, transferred the building improvements to other real estate owned ("OREO") and listed the property for sale.

On January 12, 2018, FNCB purchased its corporate center located at 200 South Blakely Street, Dunmore, Pennsylvania, for $2.15 million. FNCB had been leasing this property since 1994.

On May 30, 2018, FNCB completed the relocation and consolidation of three branches located in Luzerne County, Pennsylvania into a new state-of-the-art branch office. The three branches that were relocated are: the Hanover Township Branch located at 734 San Souci Parkway, Hanover Township, Pennsylvania; the Plains Township Branch located at 27 North River Street, Plains, Pennsylvania; and the Route 315 Branch located at 3 Old Boston Road, Pittston, Pennsylvania. The new branch office is located in the Richland 315 Development at 1150 Route 315, Wilkes-Barre (Plains Township), Luzerne County, Pennsylvania. FNCB leased the three relocated branches and leases the new Luzerne County facility. The Hanover Township Branch lease expired October 1, 2018. The Plains Township lease expires on October 31, 2020. FNCB currently operates an offsite, remote ATM at this location. Upon relocation, FNCB transferred the leasehold improvements for the Route 315 Branch to OREO at their fair value less cost to sell based upon a signed sales agreement from a third party. The sale is expected to be completed in the first quarter of 2019

On June 14, 2018, FNCB purchased the real property, improvements and fixtures located at 196 N. Main Street, Shavertown, Luzerne County, Pennsylvania for $750 thousand to relocate its Back Mountain Branch located at 1919 Memorial Highway, Shavertown, Luzerne County, Pennsylvania. The new location facilitates accessibility for customers and provides FNCB with improved retail and commercial visibility. The relocation was completed on December 19, 2018. FNCB was under an operating lease for the former location, which expired on February 28, 2019.

On November 5, 2018, the Bank received approval from its primary regulator to relocate FNCB's main office located at 102 E. Drinker Street, Lackawanna County, Pennsylvania, into a new state-of-the-art office that is being constructed directly across the street at 100 S. Blakely Street, Dunmore, Lackawanna, County, Pennsylvania. The property is currently owned by the Bank and houses a separate drive-thru location, as well as a drive-thru and a walk-up ATM. The project is anticipated to cost $2.0 million and will be funded by cash generated through normal operations. The relocation is expected to create operating efficiencies for the main office, enhance customer service and improve accessibility. FNCB has abandoned the existing drive-thru location and has recorded an abandonment charge of $148 thousand, which is included in other losses in the consolidated statement of income for the year ended December 31, 2018.

On December 14, 2018, FNCB purchased the real property, improvements and fixtures located at 360 South Mountain Boulevard, Mountain Top, Luzerne County, Pennsylvania for $550 thousand. The deed contains a restriction under which FNCB has agreed not to operate, sell, or lease the property for a period of six months from the recording of the deed. FNCB anticipates opening a new branch at this location by the end of the second quarter of 2019.

See Note 6, "Bank Premises and Equipment" of the notes to consolidated financial statements included in Item 8, "Financial Statements and Supplementary Data" to this Annual Report on Form 10-K for additional information about FNCB's properties.

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Item 3. Legal Proceedings.

On May 24, 2012, a putative shareholder filed a complaint in the Court of Common Pleas for Lackawanna County ("Shareholder Derivative Suit") against certain present and former directors and officers of FNCB (the "Individual Defendants") alleging, inter alia, breach of fiduciary duty, abuse of control, corporate waste, and unjust enrichment. FNCB was named as a nominal defendant. On February 4, 2014, the Court issued a Final Order and Judgment for the matter granting approval of a Stipulation of Settlement (the "Settlement") and dismissing all claims against FNCB and the Individual Defendants. As part of the Settlement, without admitting any fault, wrongdoing or liability, the Individual Defendants agreed to settle the derivative litigation for $5.0 million. The $5.0 million Settlement payment was made to FNCB on March 28, 2014. The Individual Defendants reserved their rights to indemnification under FNCB's Articles of Incorporation and Bylaws, resolutions adopted by the Board, the Pennsylvania Business Corporation Law and any and all rights they have against FNCB's and the Bank's insurance carriers. In addition, in conjunction with the Settlement, FNCB accrued $2.5 million related to fees and costs of the plaintiff's attorneys, which was included in non-interest expense in the consolidated statements of income for the year ended December 31, 2013. On April 1, 2014, FNCB paid the $2.5 million related to fees and costs of the plaintiff's attorneys and partial indemnification of the Individual Defendants in the amount of $2.5 million. Commencing on July 1, 2017, FNCB made partial indemnifications to the Individual Defendants through monthly principal payments, made on behalf of the Individual Defendants, of $25,000 plus accrued interest to First Northern Bank and Trust Co. On April 11, 2018, FNCB indemnified the Individual Defendants by paying in full the $2.5 million, plus accrued interest to First Northern Bank & Trust Co.

On September 5, 2012, Fidelity and Deposit Company of Maryland ("F&D") filed an action against FNCB and the Bank, as well as several current and former officers and directors of FNCB, in the United States District Court for the Middle District of Pennsylvania. F&D asserted a claim for the rescission of a directors' and officers' insurance policy and a bond that it had issued to FNCB. On November 9, 2012, FNCB and the Bank answered the claim and asserted counterclaims for the losses and expenses already incurred by FNCB and the Bank. FNCB and the other defendants defended the claims and opposed F&D's requested relief by way of counterclaims. On December 21, 2018, FNCB, the Bank and F&D resolved the dispute by entering into a mutual release of all claims. FNCB recognized a gain of $6.0 million after expenses in the fourth quarter of 2018 in connection with this insurance recovery.

On February 16, 2017, FNCB and the Bank entered into a Class Action Settlement Agreement and Release (the "Settlement Agreement") in the matters filed in the Court of Common Pleas of Lackawanna County to Steven Antonik, Individually, and as Administrator of the Estate of Linda Kluska, William R. Howells and Louise A. Howells, Summer Benjamin, and Joshua Silfee, on behalf of themselves and all other similarly situated vs. First National Community Bancorp, Inc. and First National Community Bank, Civil Action No. 2013-CV-4438 and Charles Saxe, III, Individually and on behalf of all others similarly situated vs. First National Community Bank No. 2013-CV-5071 (collectively, the "Actions"). By entering into this Settlement Agreement, the parties to the Actions have resolved the claims made in the complaints to their mutual satisfaction. FNCB has not admitted to the validity of any claims or allegations and denies any liability in the claims made and the Plaintiffs have not admitted that any claims or allegations lack merit or foundation. Under the terms of the Settlement Agreement, the parties have agreed to the following: 1) FNCB is to pay the Plaintiffs' class members the aggregate sum of Seven Hundred Fifty Thousand Dollars ($750,000) (an amount which FNCB recorded as a liability and corresponding expense in its 2015 operating results); 2) Plaintiffs shall release all claims against FNCB related to the Actions; 3) FNCB shall move to vacate or satisfy any judgments against any class members arising from the vehicle loans that are the subject of the Actions; and 4) FNCB shall waive the deficiency balance of each class member and remove the trade lines on each class members' credit report associated with the subject vehicle loans that are at issue in the Actions for Experian, Equifax, and Transunion. The Settlement Agreement provides for an Incentive Award for the representative Plaintiffs and an award to Plaintiffs' counsel of attorney's fees and reimbursement of expenses in connection with their roles in these Actions, subject to Court approval. The Settlement Agreement was preliminarily approved by Court Order on February 16, 2017. On March 2, 2017, FNCB paid the Settlement Administrator $750,000 pursuant to the terms and conditions of the Settlement Agreement. The Settlement Agreement received final Court approval on May 31, 2017. Additionally, in association with the subject vehicle loans, FNCB has completed the removal of trade lines on each class members' credit report and satisfied judgments, where applicable, in favor of class members. As previously mentioned above and in connection with the primary terms of the tentative settlement agreement entered by Order of Court on December 17, 2015, FNCB recorded a liability and corresponding expense in the amount of Seven Hundred Fifty Thousand ($750,000), which was included in FNCB's 2015 operating results.

FNCB has been subject to tax audits, and is also a party to routine litigation involving various aspects of its business, such as employment practice claims, workers compensation claims, claims to enforce liens, condemnation proceedings on properties in which FNCB holds security interests, claims involving the making and servicing of real property loans and other issues incident to its business, none of which has or is expected to have a material adverse impact on the consolidated financial condition, results of operations or liquidity of FNCB.

Item 4. Mine Safety Disclosures.

Not Applicable.

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PART II

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

Market Prices of Stock and Dividends Paid

Effective with the market opening on Monday, March 5, 2018, FNCB’s common shares began trading on The Nasdaq Stock Market LLC ("Nasdaq") under the symbol "FNCB". During the year ended December 31, 2017 through market opening on March 5, 2018. FNCB's common shares were quoted on the OTCQX under the symbol “FNCB.”

On January 28, 2019, FNCB announced that it had commenced a public offering of its shares of common stock in a firm commitment underwritten offering. Subsequently, on February 8, 2019, FNCB announced the closing of the public offering of 3,285,550 shares of its common stock, which includes 428,550 shares of common stock issued upon the exercise in full of the option to purchase additional shares granted to underwriters, at a public offering price of $7.00 per share, less an underwriting discount of $0.35 per share. FNCB received net proceeds after deducting underwriting discounts and offering expenses of $21.3 million.

Holders

As of February 28, 2019, there were approximately 1786 holders of record of FNCB’s common shares. Because many of FNCB’s shares are held by brokers and other institutions on behalf of shareholders, FNCB is unable to estimate the total number of shareholders represented by these record holders.

Dividends

Dividends declared and paid were $2.9 million, or $0.17 per share, in 2018 and $2.2 million, or $0.13 per share, in 2017. The dividend payout ratio was 21.4% for the year ended December 31, 2018. It is the present intent of the Board of Directors to continue paying quarterly dividends going forward. However, FNCB’s ability to declare and pay future dividends is dependent upon earnings, financial position, appropriate restrictions under applicable laws, legal and regulatory restrictions and other factors relevant at the time FNCB’s Board of Directors considers any declaration of any dividends. For a further discussion of FNCB’s and the Bank’s dividend restrictions, refer to Note 14, “Regulatory Matters/Subsequent Events” in the notes to consolidated financial statements in this Annual Report on Form 10-K.

On January 30, 2019, the Board of Directors declared a dividend of $0.05 per share for the first quarter of 2019. The dividend is payable on March 15, 2019 to shareholders of record as of March 1, 2019.

Equity Compensation Plans

For more information regarding FNCB's equity compensation plans, see Part III, Item 12, "Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters" in this Annual Report on Form 10-K.

Recent Sales of Unregistered Securities

None.

Purchase of Equity Securities by the Issuer and Affiliated Purchasers

None.

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Item 6. Selected Financial Data

The selected consolidated financial and other data and management's discussion and analysis of financial condition and results of operations set forth below and in Item 7 hereof is derived in part from, and should be read in conjunction with, FNCB's consolidated financial statements and notes thereto contained elsewhere herein. Certain reclassifications have been made to prior years' consolidated financial statements to conform to the current year's presentation. Those reclassifications did not impact net income.

	For the Years Ended December 31,				
(dollars in thousands, except per share data)	**2018**	**2017**	**2016**	**2015**	**2014**
Balance Sheet Data:					
Total assets	$1,237,732	$1,162,305	$1,195,599	$1,090,618	$970,029
Securities, available-for-sale	296,032	290,387	276,015	257,042	219,989
Net loans	829,581	761,609	722,860	721,926	657,747
Total deposits	1,095,629	1,002,448	1,015,139	821,546	795,336
Borrowed funds	34,240	60,278	78,847	160,112	96,504
Shareholders' equity	97,219	89,191	90,371	86,178	51,398
Income Statement Data:					
Interest income	$45,085	$37,848	$34,748	$32,201	$32,673
Interest expense	8,578	4,800	4,197	4,801	6,147
Net interest income before provision (credit) for loan and lease losses	36,507	33,048	30,551	27,400	26,526
Provision (credit) for loan and lease losses	2,550	769	1,153	(1,345)	(5,869)
Non-interest income	11,790	7,225	6,203	7,800	14,920
Non-interest expense	29,327	28,069	27,545	28,464	33,569
Income before income taxes	16,420	11,435	8,056	8,081	13,746
Income tax expense (benefit)	3,071	11,288	1,747	(27,759)	326
Net income	13,349	147	6,309	35,840	13,420
Earnings per share, basic and diluted	0.79	0.01	0.38	2.17	0.81
Capital and Related Ratios:					
Cash dividends declared per share	$0.17	$0.13	$0.09	$-	$-
Book value per share	5.78	5.32	5.43	5.22	3.12
Tier I leverage ratio	8.50%	7.74%	7.53%	7.27%	6.05%
Total risk-based capital to risk-adjusted assets	12.69%	12.08%	12.06%	11.79%	13.67%
Average equity to average total assets (1)	7.10%	8.36%	8.42%	5.64%	4.66%
Tangible equity to tangible assets	7.85%	7.67%	7.56%	7.89%	5.27%
Selected Performance Ratios:					
Return on average assets (1)	1.09%	0.01%	0.57%	3.57%	1.38%
Return on average equity (1)	15.38%	0.15%	6.82%	63.24%	29.5%
Net interest margin (2)	3.22%	3.23%	3.13%	2.99%	3.08%

Noninterest income/operating income (2)	20.56 %	15.79 %	14.88 %	18.73 %	30.30 %
Asset Quality Ratios:					
Allowance for loan and lease losses/total loans	1.13 %	1.17 %	1.15 %	1.20 %	1.72 %
Nonperforming loans/total loans	0.56 %	0.34 %	0.31 %	0.52 %	0.82 %
Allowance for loan and lease losses/nonperforming loans	202.70 %	350.43 %	376.86 %	232.05 %	208.62 %
Net charge-offs/average loans	0.25 %	0.02 %	0.21 %	0.20 %	(0.51 %)
Loan loss provision/net charge-offs	123.49 %	499.35 %	75.66 %	***	***

*** Ratio is not meaningful for 2015 and 2014.
(1) Average balances were calculated using average daily balances. Average balances for loans include non-accrual loans.
(2) Tax-equivalent adjustments were calculated using rates of 21.0 percent for 2018 and 34.0 percent for prior years.

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

Management's discussion and analysis ("MD&A") represents an overview of the financial condition and results of operations of FNCB and should be read in conjunction with our consolidated financial statements and notes thereto included in Item 8 and Risk Factors detailed in Item 1A of Part I to this Annual Report on Form 10-K.

FNCB is in the business of providing customary retail and commercial banking services to individuals, businesses and local governments and municipalities through its wholly-owned subsidiary, FNCB Bank's 16 full-service branch offices within its primary market area, Northeastern Pennsylvania, and a LPO based in Allentown, Lehigh County, Pennsylvania.

FORWARD-LOOKING STATEMENTS

FNCB may from time to time make written or oral "forward-looking statements," including statements contained in our filings with the SEC, in our reports to shareholders, and in our other communications, which are made in good faith by us pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements include statements with respect to FNCB's beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions, that are subject to significant risks and uncertainties, and are subject to change based on various factors (some of which are beyond our control). The words "may," "could," "should," "will," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan," "project," "future" and similar expressions are intended to identify forward-looking statements.

Readers are cautioned that these forward-looking statements are only predictions and are subject to risks, uncertainties, and assumption that are difficult to predict, including those under "Part I, Item 1A. Risk Factors," and elsewhere herein. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. Readers are also cautioned not to place undue reliance on any forward-looking statements, which reflect management's analysis only as of the date of this report, even if subsequently made available by FNCB on its website or otherwise. FNCB does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of FNCB to reflect events or circumstances occurring after the date of this report.

CRITICAL ACCOUNTING POLICIES

In preparing the consolidated financial statements, management has made estimates, judgments and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated statements of condition and results of operations for the periods indicated. Actual results could differ significantly from those estimates.

FNCB's accounting policies are fundamental to understanding management's discussion and analysis of its financial condition and results of operations. Management has identified the policies on the determination of the allowance for loan and lease losses ("ALLL"), securities' valuation and impairment evaluation, the valuation of other real estate owned ("OREO") and income taxes to be critical, as management is required to make subjective and/or complex judgments about matters that are inherently uncertain and could be subject to revision as new information becomes available.

The judgments used by management in applying the critical accounting policies discussed below may be affected by changes and/or deterioration in the economic environment, which may impact future financial results. Specifically, subsequent evaluations of the loan portfolio, in light of the factors then prevailing, may result in significant changes in the ALLL in future periods, and the inability to collect on outstanding loans could result in increased loan losses. In addition, the valuation of certain securities in FNCB's investment portfolio could be negatively impacted by illiquidity or dislocation in marketplaces resulting in significantly depressed market prices thus leading to impairment losses.

Allowance for Loan and Lease Losses

Management evaluates the credit quality of FNCB's loan portfolio on an ongoing basis, and performs a formal review of the adequacy of the ALLL on a quarterly basis. The ALLL is established through a provision for loan losses charged to earnings and is maintained at a level management considers adequate to absorb estimated probable losses inherent in the loan portfolio as of the evaluation date. Loans, or portions of loans, determined by management to be uncollectible are charged off against the ALLL, while recoveries of amounts previously charged off are credited to the ALLL.

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Determining the amount of the ALLL is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, qualitative factors, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. Banking regulators, as an integral part of their examination of FNCB, also review the ALLL, and may require, based on their judgments about information available to them at the time of their examination, that certain loan balances be charged off or require that adjustments be made to the ALLL. Additionally, the ALLL is determined, in part, by the composition and size of the loan portfolio.

The ALLL consists of two components, a specific component and a general component. The specific component relates to loans that are classified as impaired. For such loans, an allowance is established when the discounted cash flows, collateral value or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers all other loans and is based on historical loss experience adjusted by qualitative factors. The general reserve component of the ALLL is based on pools of unimpaired loans segregated by loan segment and risk rating categories of “Pass”, “Special Mention” or “Substandard and Accruing.” Historical loss factors and various qualitative factors are applied based on the risk profile in each risk rating category to determine the appropriate reserve related to those loans. Substandard loans on non-accrual status above the $100 thousand loan relationship threshold and all loans considered troubled debt restructurings (“TDRs”) are classified as impaired.

See Note 2, “Summary of Significant Accounting Policies” and Note 5, “Loans” of the notes to consolidated financial statements included in Item 8, “Financial Statements and Supplementary Data” to this Annual Report on Form 10-K for additional information about the ALLL.

Securities Valuation and Evaluation for Impairment

Management utilizes various inputs to determine the fair value of its investment portfolio. To the extent they exist, unadjusted quoted market prices in active markets (Level 1) or quoted prices for similar assets or models using inputs that are observable, either directly or indirectly (Level 2) are utilized to determine the fair value of each investment in the portfolio. In the absence of observable inputs or if markets are illiquid, valuation techniques are used to determine fair value of any investments that require inputs that are both unobservable and significant to the fair value measurement (Level 3). For Level 3 inputs, valuation techniques are based on various assumptions, including, but not limited to, cash flows, discount rates, adjustments for nonperformance and liquidity, and liquidation values. A significant degree of judgment is involved in valuing investments using Level 3 inputs. The use of different assumptions could have a positive or negative effect on FNCB’s financial condition or results of operations. See Note 4, “Securities” and Note 15, “Fair Value Measurements” of the notes to consolidated financial statements included in Item 8, “Financial Statements and Supplementary Data” to this Annual Report on Form 10-K for additional information about FNCB’s securities valuation techniques.

On a quarterly basis, management evaluates individual investment securities in an unrealized loss position for other than temporary impairment (“OTTI”). The evaluation for OTTI requires the use of various assumptions, including but not limited to, the length of time an investment’s fair value is less than book value, the severity of the investment’s decline, any credit deterioration of the issuer, whether management intends to sell the security, and whether it is more-likely-than-not that FNCB will be required to sell the security prior to recovery of its amortized cost basis. Debt investment securities deemed to have OTTI are written down by the impairment related to the estimated credit loss, and the non-credit related impairment loss is recognized in other comprehensive income. FNCB did not recognize any OTTI charges on investment securities for years ended December 31, 2018 and 2017 within the consolidated statements of income.

See Note 2, “Summary of Significant Accounting Policies” and Note 4, “Securities” of the notes to consolidated financial statements included in Item 8, “Financial Statements and Supplementary Data” to this Annual Report on Form 10-K for additional information about valuation of securities.

Other Real Estate Owned

OREO consists of property acquired by foreclosure, abandonment or conveyance of deed in-lieu of foreclosure of a loan, and bank premises that are no longer used for operation or for future expansion. OREO is held for sale and is initially recorded at fair value less costs to sell at the date of acquisition or transfer, which establishes a new cost basis. Upon acquisition of the property through foreclosure or deed-in-lieu of foreclosure, any adjustment to fair value less estimated selling costs is recorded to the ALLL. The determination is made on an individual asset basis. Bank premises no longer used for operations or future expansion are transferred to OREO at fair value less estimated selling costs with any related write-down included in non-interest expense. Subsequent to acquisition, valuations are periodically performed and the assets are carried at the lower of cost or fair value less cost to sell. Fair value is determined through external appraisals, current letters of intent, broker price opinions or executed agreements of sale, unless management determines that conditions exist that warrant an adjustment to the value. Costs relating to the development and improvement of the OREO properties may be capitalized; holding period costs and any subsequent changes to the valuation allowance are charged to expense as incurred.

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Income Taxes

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in FNCB's consolidated financial statements or tax returns. Fluctuations in the actual outcome of these future tax consequences could impact our consolidated financial condition or results of operations.

FNCB records an income tax provision or benefit based on the amount of tax currently payable or receivable and the change in deferred tax assets and liabilities. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial and tax reporting purposes. Management conducts quarterly assessments of all available positive and negative evidence to determine the amount of deferred tax assets that will more likely than not be realized. FNCB establishes a valuation allowance for deferred tax assets and records a charge to income if management determines, based on available evidence at the time the determination is made, that it is more likely than not that some portion or all of the deferred tax assets will not be realized. In evaluating the need for a valuation allowance, management considers past operating results, estimates of future taxable income based on approved business plans, future capital requirements and ongoing tax planning strategies. This evaluation process involves significant management judgment about assumptions that are subject to change from period to period depending on the related circumstances. The recognition of deferred tax assets requires management to make significant assumptions and judgments about future earnings, the periods in which items will impact taxable income, future corporate tax rates, and the application of inherently complex tax laws. The use of different estimates can result in changes in the amounts of deferred tax items recognized, which may result in equity and earnings volatility because such changes are reported in current period earnings. Management's evaluation as of December 31, 2018 and 2017 concluded that no valuation allowance was necessary for net deferred tax assets.

On December 22, 2017, President Trump signed into law H.R.1., an Act to provide for reconciliation pursuant to title II and V of the concurrent resolution on the budget for fiscal year 2018, originally introduced in Congress and informally known as the "Tax Cuts and Jobs Act", which among other things, reduced the federal maximum corporate income tax rate from 35.0% to 21.0% effective January 1, 2018. In accordance with generally accepted accounting principles ("GAAP"), the enactment of this new tax legislation required FNCB to revalue its deferred tax assets at the new corporate statutory rate of 21.0% as of December 31, 2017. The revaluation of FNCB's deferred tax assets, net of deferred tax liabilities, resulted in a reduction in its net deferred tax assets of $8.0 million in the fourth quarter of 2017, with a corresponding increase in income tax expense. This revaluation adjustment had an impact of ($0.48) per diluted share, and tangible book value of ($0.48) per share based on weighted-average diluted shares for the year ended December 31, 2017 and shares outstanding at December 31, 2017, respectively. There was no significant impact to FNCB's regulatory capital ratios or liquidity resulting from the revaluation.

In connection with determining the income tax provision or benefit, management considers maintaining liabilities for uncertain tax positions and tax strategies that it believes contain an element of uncertainty. Periodically, management evaluates each of FNCB's tax positions and strategies to determine whether a liability for uncertain tax benefits is required. As of December 31, 2018 and 2017, management determined that FNCB did not have any uncertain tax positions or tax strategies and that no liability was required to be recorded.

See Note 2, “Summary of Significant Accounting Policies” and Note 10, “Income Taxes” of the notes to consolidated financial statements included in Item 8, “Financial Statements and Supplementary Data” to this Annual Report on Form 10-K for additional information about the accounting for income taxes.

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New Authoritative Accounting Guidance and Accounting Guidance to be Adopted in Future Periods

For information regarding new authoritative accounting guidance adopted by FNCB during the year ended December 31, 2018 and accounting guidance that FNCB will adopt in future periods, see Note 2, “Summary of Significant Accounting Policies” of the notes to consolidated financial statements included in Item 8, “Financial Statements and Supplementary Data” to this Annual Report on Form 10-K.

EXECUTIVE OVERVIEW

The following overview should be read in conjunction with this MD&A in its entirety.

Results of Operations

FNCB reported earnings in 2018 of $13.3 million, of $0.79 per diluted common share, an increase of $13.2 million, compared to $0.1 million, or $0.01 per diluted common share, in 2017. The increase in 2018 net income compared to 2017 was primarily attributable to a decrease in income tax expense, coupled with an increase in net interest income and non-interest income, partly offset by increases in the provision for loan and lease losses and non-interest expenses. Net interest income improved $3.5 million, or 10.5%, to $36.5 million in 2018 from $33.0 million in 2017. The improvement resulted primarily from solid growth in interest-earning assets, coupled with higher yields earned on loans and investments, and partly offset by higher volumes of and rates paid on interest-bearing liabilities. Non-interest income increased $4.6 million, or 63.2%, to $11.8 million in 2018 from $7.2 million in 2017. FNCB received an insurance recovery of $6.0 million in the fourth quarter of 2018, which was the primary contributor to the increase in non-interest income. In 2018, FNCB realized a net loss of $4 thousand on the sale of available-for-sale securities, a decrease of $1.6 million compared to a net gain of $1.6 million realized on the sale of available-for-sale securities in 2017, which partially offset the increase in non-interest income from the insurance recovery. Income tax expense decreased $8.2 million, or 72.8%, to $3.1 million in 2018 as compared to $11.3 million in 2017, which primarily resulted from the revaluation of net deferred tax assets during 2017 following the enactment of the Tax Cuts and Jobs Act, along with a decrease in the corporate income tax rate for 2018. These positive factors were offset by an increase in the provision for loan and lease losses of $1.8 million, or 231.6%, to $2.6 million in 2018 from $0.8 million in 2017. Non-interest expenses increased by $1.2 million, or 4.5%, $29.3 million in 2018 from $28.1 million in 2017.

Return on average assets and return on average shareholders’ equity equaled 1.09% and 15.38%, respectively, in 2018, compared to 0.01% and 0.15%, respectively, in 2017. FNCB paid dividends to holders of common stock of $0.17 per share and $0.13 per share for the years ended December 31, 2018 and 2017, respectively.

Balance Sheet Profile

Total assets increased $75.4 million, or 6.5%, to $1.238 billion at December 31, 2018 from $1.162 billion at December 31, 2017. The increase in total assets primarily reflected strong growth in interest-earning assets. Specifically, loans, net of net deferred costs and unearned income, increased $68.5 million, or 8.9%, to $839.1 million at December 31, 2018 from $770.6 million at December 31, 2017. In addition, securities available for sale increased $6.5 million, or 2.3%, to $296.0 million at December 31, 2018 from $289.5 million at the end of 2017. The asset growth was funded with an increase in total deposits of $93.2 million, or 9.3%, to $1.096 billion at December 31, 2018 from $1.002 billion at December 31, 2017. The increase in deposits was primarily attributable to increases in retail and wholesale time deposits. Borrowings through the Federal Home Loan Bank of Pittsburgh decreased $26.0 million, or 57.9%, to $18.9 million at December 31, 2018 from $44.9 million at December 31, 2017.

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Total shareholders’ equity increased $8.0 million, or 9.0%, to $97.2 million at December 31, 2018 from $89.2 million at the end of 2017, which resulted primarily from net income in 2018 of $13.3 million, partially offset by a $2.8 million increase in accumulated other comprehensive loss related to depreciation in the fair value of available-for-sale debt securities, net of deferred taxes, and year-to-date dividends declared of $2.9 million.

At December 31, 2018, FNCB’s total risk-based capital ratio and the Tier 1 leverage ratio were 12.69% and 8.50%, respectively. The respective ratios for the Bank at December 31, 2018 were 12.17% and 8.27%. The ratios for both FNCB and the Bank exceeded the 10.00% and 5.00% required to be well capitalized under the prompt corrective action provisions of the Basel III capital framework for U.S. banking organizations.

Management’s Focus in 2018

During 2018, FNCB and the Bank completed a re-branding that included new logos with a new tagline, "Simply Better," as well as a new mission statement, "To make your banking experience simply better." Throughout 2018, management developed strategies and initiatives aimed at delivering its mission of bettering the banking experience for customers, shareholders and employees, improving FNCB's long-term financial performance by improving efficiency, increasing interest income through commercial and retail loan growth initiatives, managing interest expense by growing core deposits, developing additional sources of non-interest income and enhancing the marketability and liquidity of FNCB’s stock.

Aligned with enhancing the marketability and liquidity of FNCB’s stock, on December 29, 2017, FNCB filed a listing application with The Nasdaq Stock Market LLC (“Nasdaq”). FNCB subsequently received approval from Nasdaq on February 26, 2018 to list its common shares for trading on The Nasdaq Capital Market®. FNCB’s shares of common stock began trading on Nasdaq effective with the market opening on Monday, March 5, 2018. Effective June 25, 2018, FNCB was added as a member of the Russel Microcap® Index. Management believes that the transition to Nasdaq, along with inclusion in the Russel Microcap® Index, will provide greater visibility and increase trading of FNCB’s common stock. On October 29, 2018, members of FNCB’s management team, the Board of Directors and the Bank's Advisory Board rang the closing bell at the Nasdaq Marketsite in Times Square in New York, NY.

To facilitate loan and deposit growth initiatives, enhance efficiency, and improve the customer experience, on May 30, 2018, FNCB opened a new, state-of-the-art branch office located in Plains Township, Luzerne County, Pennsylvania. The new branch features the “personal banker” model which provides customers with an enhanced, more personalized banking experience. The new facility is part of the comprehensive branch network improvement program announced during 2017, and has consolidated three branches located in Luzerne County, Pennsylvania to this new location. The three branches that were consolidated include: a branch located at 734 San Souci Parkway, Hanover Township, Pennsylvania; a branch located at 27 North River Street, Plains, Pennsylvania; and a branch located at 3 Old Boston Road, Pittston, Pennsylvania. Each of these three branches were located within 6 miles of the new Plains Rt. 315 branch.

In addition, management evaluates FNCB's delivery channels on an ongoing basis as part of it's branch network improvement plan and has executed the following initiatives:

On June 14, 2018, FNCB purchased real property, improvements and fixtures located at 196 North Main Street, Shavertown, Luzerne County, Pennsylvania for $750 thousand for the purpose of relocating its Back Mountain branch located at 1919 Memorial Highway, Shavertown, Luzerne County, Pennsylvania. The relocation to the new facility, which was finalized on December 19, 2018, facilitates accessibility for customers and provides FNCB greater retail and commercial visibility.

During the third quarter of 2018, FNCB completed final enhancements to its entire automated teller machine ("ATM") network which included the replacement of all existing machines with the newest generation machines. This initiative better safeguards sensitive customer information and creates internal efficiency as the new machines are equipped with anti-fraud and anti-skimming technology and provides for the direct imaging of all deposit transactions.

On September 27, 2018, FNCB executed a contract with Branch Banking and Trust Company to purchase the real property, improvements and fixtures located at 360 South Mountain Boulevard, Mountain Top, Luzerne County, Pennsylvania for $550 thousand for the purpose of opening a branch office. The contract contains a deed restriction under which FNCB has agreed to not operate, sell, or lease the property for a period of six months from the recording of the deed. FNCB has received regulatory approvals and closed on the purchase of the property on December 14, 2018. The new branch is anticipated to open at this location by the end of the second quarter of 2019.

On November 5, 2018, FNCB received approval from its primary regulator to relocate the Bank's main office located at 102 E. Drinker Street, Dunmore, Lackawanna County, Pennsylvania, into a new state-of -the-art office that will be built directly across the street at 100 S. Blakely Street, Dunmore, Pennsylvania. The property is currently owned by the Bank and houses a separate drive-thru location, as well as a drive-thru and a walk-up ATM. The project is anticipated to cost $2.0 million and will be funded by cash generated through operations. The relocation is expected to create operating efficiencies for the main office, enhance customer service and improve customer accessibility.

Management is also evaluating the development of a new state-of-the-art facility on a property already owned by FNCB located in Taylor Borough, Lackawanna County, Pennsylvania, as well as potential locations to expand its branch network into the Lehigh Valley market area of Pennsylvania.

With regard to commercial and retail loan growth initiatives, during the third quarter of 2018, FNCB completed the implementation of a bank-wide customer relationship management ("CRM") system to improve customer service, enhance market share and create cross-sales opportunities between retail and commercial business units. The CRM system became operational on October 9, 2018.

Over the past year, management has invested in staff additions to provide improved customer experiences, increase loan growth, enhance revenue streams and manage credit risk. Recent specialized lending staff additions include an indirect auto lending relationship manager, a retail lending sales operations manager and a chief credit officer. Additionally, FNCB plans to expand operations related to the limited production office located in Allentown, Lehigh County, Pennsylvania to include the offering of retail lending products. FNCB also recently enhanced its third-party wealth management services, now offered through LPL Financial, LLC, which provides FNCB's wealth management team the ability to utilize the resources of some of the finest investment management, administrators and financial service providers available in the industry. Finally, at the end of 2018, FNCB announced the appointment of a Chief Banking Officer with extensive managerial and sales experience who will head up the Bank's commercial lending, retail lending and retail banking units.

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SUMMARY OF FINANCIAL PERFORMANCE

Net Interest Income

Net interest income is the difference between (i) interest income, interest and fees on interest-earning assets, and (ii) interest expense, interest paid on deposits and borrowed funds. Net interest income represents the largest component of FNCB's operating income and, as such, is the primary determinant of profitability. Net interest income is impacted by variations in the volume, rate and composition of earning assets and interest-bearing liabilities, changes in general market rates and the level of non-performing assets. Interest income is shown on a fully tax-equivalent basis using the corporate statutory tax rate of 21.0% in 2018 and 34% in 2017.

Over the past year, the Federal Open Market Committee ("FOMC") increased the target rate a total of 100 basis points through four 25-basis point actions, occurring on March 21, 2018, June 13, 2018, September 26, 2018 and December 19, 2018. These actions resulted in corresponding increases in the national prime rate to 5.50% at December 31, 2018 from 4.50% at December 31, 2017. FNCB experienced an increase in loan yields throughout 2018 as compared to 2017, as variable- and adjustable-rate loans repriced upward and new loans were originated at higher interest rates. Throughout 2018, the increase in market interest rates also led to notable increases in funding costs across interest-bearing deposits and borrowed funds.

Tax-equivalent net interest income improved in 2018, increasing $3.2 million to $37.0 million compared to $33.7 million in 2017. The 9.6% increase in tax-equivalent net interest income primarily reflected a $7.0 million increase in tax-equivalent interest income, partially offset by a $3.8 million increase in interest expense. Tax-equivalent interest income in 2018 was positively impacted by significant growth in average earning assets, coupled with increases in the yields earned on taxable loans and investments and interest-earning deposits in other banks. The increase in interest expense largely reflected increases in the rates paid on interest-bearing demand deposits, time deposits, and borrowed funds, coupled with increases in volumes of time deposits and borrowed funds.

Despite the strong growth in average earning assets and tax-equivalent net interest income, FNCB's tax-equivalent interest margin decreased 1 basis point to 3.22% in 2018 from 3.23% in 2017, as the cost to fund earning assets outpaced the increase in earning asset yields. Tax-equivalent net interest margin, a key measurement used in the banking industry to measure income from earning assets relative to the cost to fund those assets, is calculated by dividing tax-equivalent net interest income by average interest-earning assets. Additionally, rate spread, the difference between the average yield on interest-earning assets shown on a fully tax-equivalent basis and the average cost of interest-bearing liabilities, was 3.07% for the year ended December 31, 2018, a decrease of 6 basis points compared to 3.13% for the year ended December 31, 2017.

Tax-equivalent interest income increased $7.0 million, or 18.2%, to $45.5 million in 2018 from $38.5 million in 2017. The growth in tax-equivalent interest income reflected strong growth in interest-earning assets, which increased $100.7 million, or 9.6% to $1.147 billion in 2018 from $1.046 billion in 2017. Average loans increased $97.4 million, or 13.2%, to $835.7 million in 2018 from $738.3 million, resulting in an increase to tax-equivalent interest income of $4.2 million. In addition, average investments increased $16.5 million, or 5.7%, to $306.5 million in 2018 from $290.0 million in 2017, resulting in an increase to tax-equivalent interest income of $0.5 million. Average interest-bearing deposits in other banks decreased $13.2 million, or 73.4%, to $4.7 million in 2018 from $17.9 million in 2017, resulting in a decrease to tax-equivalent interest income of $0.1 million. Accompanying the growth in interest-earning assets was a 29-basis point improvement in the tax-equivalent yield on average earning assets to 3.97% in 2018 from 3.68% in 2017. Comparing 2018 and 2017, the tax-equivalent yield earned on the loan portfolio increased 28 basis points, the tax-equivalent yield earned on the investment portfolio increased 11 basis points, and the tax-equivalent yield earned on interest-bearing deposits in other banks increased 88 basis points, contributing $2.1 million, $0.3 million, and $0.1 million, respectively, to the improvement in tax-equivalent interest income.

Increases in interest rates also drove an increase in interest expense of $3.8 million, or 78.7%, to $8.6 million in 2018 from $4.8 million in 2017. Rates paid on interest-bearing deposits increased 27 basis points to 0.71% in 2018 from 0.44% in 2017. The increase in deposit rates was concentrated in interest-bearing demand deposits, which increased 21 basis points to 0.57% in 2018 as compared to 0.36% in 2017 and time deposits, which increased 43 basis points to 1.23% in 2018 as compared to 0.80% in 2017. The increases in rate on interest-bearing demand and time deposits contributed $1.1 million and $1.0 million, respectively, to the increase in interest expense. The rate paid on savings deposits remained steady at 0.13% for both 2018 and 2017. Additionally, the rate paid on borrowed funds increased 46 basis points to 2.22% in 2018 from 1.76% in 2017, contributing $0.4 million to the overall increase in interest expense.

Average interest-bearing liabilities increased $82.5 million, or 9.4%, to $957.6 million in 2018 from $875.1 million in 2017 and resulted in a $1.3 million increase in interest expense. Specifically, a $38.0 million, or 19.2%, increase in average time deposits to $236.1 million in 2018 from $198.1 million in 2017 was the primary contributor to the $0.3 million increase in interest expense on interest-bearing deposits. Average balances of interest-bearing demand remained steady when comparing 2018 and 2017, increasing by only $0.8 million, or 0.2%, while average savings deposits declined $3.0 million, or 3.0%, comparing the same time periods. Average borrowed funds increased $46.8 million, or 64.3%, to $119.6 million in 2018 as compared to $72.8 million in 2017, contributing $1.0 million to the increase in interest expense.

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Non-accrual loans

The interest income that would have been earned on non-accrual and restructured loans outstanding at December 31, 2018 and 2017 in accordance with their original terms approximated $218 thousand and $157 thousand, respectively. Interest income on impaired loans of $417 thousand and $392 thousand was recognized based on payments received in 2018 and 2017, respectively.

The following table presents the components of net interest income for the three years ended December 31, 2018, 2017 and 2016:

Summary of Net Interest Income

	Year ended December 31, 2018			**Year ended December 31, 2017**			**Year ended December 31, 2016**		
(dollars in thousands)	**Average Balance**	**Interest**	**Yield/ Cost**	**Average Balance**	**Interest**	**Yield/ Cost**	**Average Balance**	**Interest**	**Yield/ Cost**
ASSETS									
Earning assets (2)(3)									