Section 1: 10-K (10-K)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2018

or

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

For the transition period from to

Commission File Number: 000-52598

KENTUCKY BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

Kentucky	**61-0993464**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
P.O. Box 157, Paris, Kentucky	**40362-0157**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: **(859)987-1795**

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

Title of each class	Name on each exchange on which registered
Common Stock, no par value per share	OTC QX

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 to Section 13 or Section 15(d) of the Exchange 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 (229.405 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 ☒

Aggregate market value of voting stock held by non-affiliates as of June 30, 2018 was approximately $125.4 million. For purposes of this calculation, it is assumed that the Bank's Trust Department, directors, executive officers and beneficial owners of more than 5% of the registrant's outstanding voting stock are affiliates.

Number of shares of Common Stock outstanding as of March 01, 2019: 5,981,326

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive Proxy Statement for its Annual Meeting of Stockholders to be held on May 21, 2019 are incorporated by reference into Items 10, 11, 12, 13 and 14 of Part III.

PART I

Item 1. Business

General

Kentucky Bancshares, Inc. ("Company," "Kentucky," "we," "our" and "us") is a bank holding company headquartered in Paris, Kentucky. The Company was organized in 1981 and is registered under the Bank Holding Company Act of 1956, as amended ("BHCA").

The Company conducts its business in the Commonwealth of Kentucky through one banking subsidiary, Kentucky Bank, and one non-bank subsidiary KBI Insurance Company.

Kentucky Bank is a commercial bank and trust company organized under the laws of Kentucky. Kentucky Bank has its main office in Paris (Bourbon County), with additional offices in Paris, Cynthiana (Harrison County), Georgetown (Scott County), Lexington (Fayette), Morehead (Rowan County), Nicholasville (Jessamine County), Richmond (Madison County), Sandy Hook (Elliott County), Versailles (Woodford County), Wilmore (Jessamine County) and Winchester (Clark County). The deposits of Kentucky Bank are insured up to prescribed limits by the Deposit Insurance Fund ("DIF") of the Federal Deposit Insurance Corporation ("FDIC"). KBI Insurance Company is a captive insurance subsidiary and was incorporated in 2014.

The Company had total assets of $1.1 billion, total deposits of $850.4 million and stockholders' equity of $106.8 million as of December 31, 2018. The Company's principal executive office is located at 339 Main Street, Paris, Kentucky 40361, and the telephone number at that address is (859) 987-1795.

Business Strategy

The Company's current business strategy is to operate a well-capitalized, profitable and independent community bank with a significant presence in Central and Eastern Kentucky. Management believes the optimum way to grow the Company is by attracting new loan and deposit customers within its existing markets through its product offerings and premier customer service. Management continues to consider opportunities for branch expansion and will also consider acquisition opportunities that help advance its strategic objectives.

Lending

Kentucky Bank is engaged in general full-service commercial and consumer banking. A significant part of Kentucky Bank's operating activities include originating loans, approximately 81% of which are secured by real estate at December 31, 2018. Kentucky Bank makes commercial, agricultural and real estate loans to its commercial customers, with emphasis on small-to-medium-sized industrial, service and agricultural businesses. It also makes residential mortgage, installment and other loans to its individual and other non-commercial customers.

Loan Rates: Kentucky Bank offers variable and fixed rate loans. Loan rates on variable rate loans generally adjust upward or downward based on changes in the loan's index. Rate adjustments on variable rate loans are made from 1 day to 5 years. Variable rate loans may contain provisions that cap the amount of interest rate increases or decreases over the life of the loan. In addition to the lifetime caps and floors on rate adjustments, loans secured by residential real estate may contain provisions that limit annual increases at a maximum of 200 basis points. There is usually no annual limit applied to loans secured by commercial real estate.

Credit Risk: Commercial lending and real estate construction lending, generally include a higher degree of credit risk than other loans, such as residential mortgage loans. Commercial loans, like other loans, are evaluated at the time of approval to determine the adequacy of repayment sources and collateral requirements. Collateral requirements vary to some degree among borrowers and depend on the borrower's financial strength, the terms and amount of the loan, and collateral available to secure the loan. Credit risk results from the decreased ability or willingness to pay by a borrower. Credit risk also results when a liquidation of collateral occurs and there is a shortfall in collateral value as compared to a loan's outstanding balance. For construction loans, inaccurate initial estimates of a project's costs and the property's completed value could weaken the Company's position and lead to the property having a value that is insufficient to satisfy full payment of the amount of funds advanced for the property.

Secured and unsecured consumer loans generally are made for automobiles, boats, and other motor vehicles. In most cases, loans are restricted to Kentucky Bank's general market area.

Other Products: Kentucky Bank offers its customers a variety of other services, including checking, savings, money market accounts, certificates of deposits, safe deposit facilities, credit cards and other consumer-oriented financial services. Kentucky Bank has Internet banking, including bill payment available to its customers at www.kybank.com. Through its Wealth Management Department, Kentucky Bank provides brokerage services, annuities, life and long term care insurance, personal trust and agency services (including management agency services).

Competition and Market Served

Competition: The banking business is highly competitive. Competition arises from a number of sources, including other bank holding companies and commercial banks, consumer finance companies, thrift institutions, other financial institutions and financial intermediaries. In addition to commercial banks, savings and loan associations, savings banks and credit unions actively compete to provide a wide variety of banking services. Mortgage banking firms, finance companies, insurance companies, brokerage companies, financial affiliates of industrial companies and government agencies provide additional competition for loans and for many other financial services. Kentucky Bank also currently competes for interest-bearing funds with a number of other financial intermediaries, including brokerage firms and mutual funds, which offer a diverse range of investment alternatives. Some of the Company's competitors are not subject to the same degree of regulatory review and restrictions that apply to the Company and its subsidiary bank. In addition, the Company must compete with much larger financial institutions that have greater financial resources than the Company.

Market Served. We primarily conduct our business in the Commonwealth of Kentucky. Our primary market areas consist of Bourbon, Clark, Elliott, Fayette, Harrison, Jessamine, Madison, Rowan, Scott, Woodford and surrounding counties in Kentucky. Per capita personal income for Kentucky during the third quarter increased from $40,682 in 2017 to $41,889 in 2018, according to data published by the Federal Reserve Bank of St. Louis. The Bureau of Labor Statistics reports that the unemployment rate in Kentucky was unchanged from 2017 to 2018. The unemployment rate in Kentucky was 4.4% for both December of 2018 and 2017.

Supervision and Regulation

Governing Regulatory Institutions: As a bank holding company, the Company is subject to the regulation and supervision of the Federal Reserve Board. The Company's subsidiary bank is subject to supervision and regulation by applicable state and federal banking agencies, including the Federal Reserve Board, the Federal Deposit Insurance Corporation and the Kentucky Department of Financial Institutions. Kentucky Bank is also subject to various requirements and restrictions under federal and state law, including requirements to maintain reserves against deposits, restrictions on the types and amounts of loans that may be granted and the interest that may be charged thereon, and limitations on the types of investments that may be made and the types of services that may be offered. In addition to the impact of regulation, Kentucky Bank is affected significantly by the actions of the Federal Reserve Board as it attempts to control the money supply and credit availability in order to influence the economy. The company also has a captive insurance subsidiary which is regulated by the State of Nevada Division of Insurance.

Laws Protecting Deposits: There are a number of obligations and restrictions imposed on bank holding companies and their depository institution subsidiaries by federal law and regulatory policy. These obligations and restrictions are designed to reduce potential loss exposure to the depositors of such depository institutions and to the FDIC insured funds in the event the depository institution becomes in danger of default or is in default. For example, under a policy of the Federal Reserve Board with respect to bank holding company operations, a bank holding company is required to serve as a source of financial strength to its subsidiary depository institutions and commit resources to support such institutions in circumstances where it might not do so absent such policy. In addition, the "cross-guarantee" provisions of federal law require insured depository institutions under common control to reimburse the FDIC for any loss suffered or reasonably anticipated as a result of the default of a commonly controlled insured depository institution or for any assistance provided by the FDIC to a commonly controlled insured depository institution in danger of default.

The federal banking agencies also have broad powers under current federal law to take prompt corrective action to resolve problems of insured depository institutions. The extent of these powers depends upon whether the institutions in question are "well capitalized", "adequately capitalized", "undercapitalized", "significantly undercapitalized" or "critically undercapitalized", as such terms are defined under uniform regulation defining such capital levels issued by each of the federal banking agencies.

Capital and Liquidity: On July 2, 2013, the Federal Reserve approved final rules known as the "Basel III Capital Rules" substantially revising the risk-based capital and leverage capital requirements applicable to bank holding companies and depository institutions. The Basel III Capital Rules address the components of capital and other issues affecting the numerator in banking institutions' regulatory capital ratios. Certain of the Basel III Capital Rules came into effect for the Company and Kentucky Bank on January 1, 2015; these rules are subject to a phase-in period which began on January 1, 2015.

Under the current rules, which were effective January 1, 2015, the Company is subject to additional capital requirements that include: (i) creation of a new required ratio for common equity Tier 1 ("CET1") capital, (ii) an increase to the minimum Tier 1 Risk-based Capital ratio, (iii) changes to risk-weightings of certain assets for purposes of the risk-based capital ratios, (iv) creation of an additional capital conservation buffer in excess of the required minimum capital ratios, and (v) changes to what qualifies as capital for purposes of meeting these capital requirements.

The Basel III Capital Rules were fully phased in effective January 1, 2019 and require banking organizations to maintain:

- a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% CET1 ratio as that buffer is phased-in, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7.0% upon full implementation);
- a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the 2.5% capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased-in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation);
- a minimum ratio of total capital (that is, Tier 1 plus Tier 2 capital) to risk-weighted assets of at least 8.0%, plus the 2.5% capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased-in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation); and
- a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to adjusted average consolidated assets.

The Basel III Capital Rules also provide for a "countercyclical capital buffer" that is applicable to only certain covered institutions and is not expected to have any current applicability to the Company or Kentucky Bank.

The aforementioned capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer will face limitations on the payment of dividends, common stock repurchases and discretionary cash payments to executive officers based on the amount of the shortfall.

The Basel III Capital Rules provides for a number of deductions from and adjustments to CET1. 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 CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Under the Basel III Capital Rules, the Company and Kentucky Bank were given a one-time election ("Opt-out Election") to filter certain accumulated other comprehensive income ("AOCI") components, comparable to the treatment under the previous general risk-based capital rule. The Company and Kentucky Bank elected to choose the AOCI Opt-out Election.

Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and are being phased-in over a five-year period (20% per year). The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and is being phased-in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019). In addition, the Basel III Capital Rules revise the rules for calculating risk-weighted assets to enhance their risk sensitivity. They establish a new framework under which mortgage-backed securities and other securitization exposures are subject to risk-weights ranging from 20% to 1,250%.

The rules also establish adjusted risk-weights for credit exposures, including multi-family and commercial real estate exposures that are 90 days or more past due or on non-accrual, are subject to a 150% risk-weight, except in situations where qualifying collateral and/or guarantees are in place. The existing treatment of residential mortgage exposures will remain subject to either a 50% risk-weight (for prudently underwritten owner-occupied first liens that are current or less than 90 days past due) or a 100% risk-weight (for all other residential mortgage exposures including 90 days or more past due exposures). As shown in Note 19, the Company and Kentucky Bank meet all capital adequacy requirements, and management does not anticipate any adverse impact from the implementation of the new capital ratio.

Deposit Insurance: The Company is subject to several deposit insurance assessments, which are described below:

FDIC Assessments. The Company's subsidiary bank is a member of the FDIC, and its deposits are insured by the FDIC's Deposit Insurance Fund ("DIF") up to the amount permitted by law. The Company's subsidiary bank is thus subject to FDIC deposit insurance assessments. The FDIC utilizes a risk-based assessment system that imposes insurance premiums based upon a risk matrix that takes into account a bank's capital level and supervisory rating.

The assessment base must, with some possible exceptions, equal average consolidated total assets minus average tangible equity. The FDIC has adopted a DIF restoration plan to ensure that the reserve ratio increases to 1.35% from 1.15% of insured deposits by 2020. The assessment regulations (12 CFR Part 327) provide that after the reserve ratio reaches 1.38 percent (and provided that it remains at least 1.38 percent), the FDIC will automatically apply small bank (total consolidated assets of less than $10 billion) credits to reduce small banks' regular deposit insurance assessments up to the full amounts of their assessments or the full amount of their credits, whichever is less. Credits will be awarded to any bank, including any small bank affiliate of a large bank, that was a small bank at some point during the credit calculation period (i.e., credit accruing institution). These credits are likely to start on the June 2019 invoice.

Financing Corporation ("FICO") Assessments. FICO assessment costs were $29 thousand in 2018, $49 thousand in 2017 and $50 thousand in 2016. FICO is a mixed-ownership government corporation established by the Competitive Equality Banking Act of 1987 possessing assessment powers in addition to the FDIC. The FDIC acts as a collection agent for FICO, whose sole purpose is to function as a financing vehicle for the now defunct Federal Savings & Loan Insurance Corporation. Outstanding FICO bonds, which are 30-year noncallable bonds, mature in 2019. Final FICO payments will occur in 2019.

Dodd-Frank Act: On July 21, 2010, financial regulatory reform legislation entitled the "Dodd-Frank Wall Street Reform and Consumer Protection Act" (the "Dodd-Frank Act") was signed into law. The Dodd-Frank Act significantly restructured the financial regulatory environment in the United States. The Dodd-Frank Act contains numerous provisions that affect all bank holding companies and banks, including Kentucky Bancshares and Kentucky Bank, some of which are described in more detail below. The scope and impact of many of the Dodd-Frank Act provisions were determined and issued over time. The impact of the Dodd-Frank Act on the Company has been substantial. Provisions in the legislation that affect the payment of interest on demand deposits and collection of interchange fees increased the costs associated with certain deposits and placed limitations on certain revenues those deposits generate.

Volcker Rule: On December 10, 2013, the federal bank regulatory agencies adopted final rules that implement a part of the Dodd-Frank Act commonly referred to as the "Volcker Rule." The Volcker Rule attempts to reduce risk and banking system instability by restricting U.S. banks from investing in or engaging in proprietary trading and speculation and imposing a strict framework to justify exemptions for underwriting, market making and hedging activities. U.S. banks will be restricted from investing in funds with collateral comprised of less than 100% loans that are not registered with the SEC and from engaging in hedging activities that do not hedge a specific identified risk. The Volcker Rule has not had a significant effect on operations of the Company. The roll-back of some Dodd-Frank provisions in 2018 included exempted smaller banks (under $10 billion in assets) from complying with the Volcker rule.

Consumer Regulations: In addition to the laws and regulations discussed above, Kentucky Bank is also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. While the list set forth herein is not exhaustive, these laws and regulations include the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Real Estate Settlement Procedures Act, the Fair Housing Act and the Fair and Accurate Transactions Act, among others. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with clients when taking deposits or making loans.

These laws also limit Kentucky Bank's ability to share information with affiliated and unaffiliated entities. The bank must comply with the applicable provisions of these consumer protection laws and regulations as part of its ongoing business operations.

Dividend Restrictions: There are various legal and regulatory limits on the extent to which the Company's subsidiary bank may pay dividends or otherwise supply funds to the Company. In addition, federal and state regulatory agencies also have the authority to prevent a bank or bank holding company from paying a dividend or engaging in any other activity that, in the opinion of the agency, would constitute an unsafe or unsound practice. Dividends paid by the subsidiary bank have provided substantially all of the Company's operating funds, and this may reasonably be expected to continue for the foreseeable future.

Employees

At December 31, 2018, the number of full time equivalent employees of the Company was 232.

Nature of Company's Business

The business of the Company is not seasonal. The Company's business does not depend upon a single customer, or a few customers, the loss of any one or more of which would have material adverse effect on the Company.No material portion of the Company's business is subject to renegotiation of profits or termination of contracts or subcontracts at the election of any governmental entity.

Available Information

The Company files annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports with the Securities and Exchange Commission ("SEC") pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934.

The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC on its website at www.sec.gov. The Company's website is located at www.kybank.com.

Item 1A. Risk Factors

There are factors, many beyond our control, which may significantly affect the Company's financial position and results of operations. Some of these factors are described below in the sections titled financial risk, business risk and operational risk. These risks are not totally independent of each other; some factors affect more than one type of risk. These include regulatory, economic, and competitive environments.

As part of the annual internal audit plan, our risk management department meets with management to assess these risks throughout the Company. Many risks are further addressed in other sections of this Form 10-K document. Additional risks and uncertainties that management is not aware of or focused on or that management currently deems immaterial may also impair the Company's business operations. This report is qualified in its entirety by these risk factors.

Industry Risk

Industry risk includes risks that affect the entire banking service industry.

Significant decline in general economic conditions will negatively affect the financial results of our banking operations. Kentucky Bank serves both individuals and business customers throughout Central and Eastern Kentucky. The substantial majority of our loan portfolio is to individuals and businesses in these markets. As a result, our financial condition, results of operations and cash flows are affected by local and regional economic conditions. A downturn in these economies could have a negative impact on us and the ability of Kentucky Bank's customers to repay their loans. The value of the collateral securing loans to borrowers may also decline as the economy declines. As a result, deteriorating economic conditions in these markets could cause a decline in the overall quality of our loan portfolio requiring us to charge-off a higher percentage of loans and/or increase our allowance for loan losses.

A decline in economic conditions in these markets may also force customers to utilize deposits held by Kentucky Bank in order to pay current expenses causing Kentucky Bank's deposit base to shrink.
As a result Kentucky Bank may have to borrow funds at higher rates in order to meet liquidity needs. These events may have a negative impact on our earnings and financial condition.

Significant declines in U.S. and global markets could have a negative impact on our earnings. The capital and credit markets could experience extreme disruption. These conditions result in less liquidity, greater volatility, widening of credit spreads and a lack of price transparency in certain asset types. In many cases, markets could exert downward pressure on stock prices, security prices and credit capacity for certain issuers without regard to those issuers' underlying financial strength. Sustained weakness in business and economic conditions in any or all of the domestic or foreign financial markets could result in credit deterioration in investment securities held by us, rating agency downgrades for such securities or other market factors that (such as lack of liquidity for re-sales, absence of reliable pricing information or unanticipated changes in the competitive market) could result in us having to recognize other-than-temporary impairment in the value of such investment securities, with a corresponding charge against earnings. If the markets deteriorate further, these conditions may be material to our ability to access capital and may adversely impact results of operations.

Further, Kentucky Bank's trust and investment services income could be impacted by fluctuations in the securities market. A portion of this revenue is based on the value of the underlying investment portfolios. If the values of those investment portfolios decline, Kentucky Bank's revenue could be negatively impacted.

The exercise of regulatory power may have negative impact on our results of operations and financial condition. We are subject to extensive federal and state regulation, supervision and examination. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, rather than corporate shareholders. These regulations affect our lending practices, capital structure, investment practices, dividend policy, operations and growth, among other things. These regulations also impose obligations to maintain appropriate policies, procedure and controls. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect us in substantial and unpredictable ways.

Such changes could subject us to additional costs, limit the types of financial services and products that could be offered, and/or increase the ability of non-banks to offer competing financial services and products, among other things.Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil penalties and/or reputation damage, which could have a material adverse effect on our business, financial condition and result of operations.

Regulation of the Company and our subsidiaries is expected to continue to expand in scope and complexity in the future. These laws are expected to have the effect of increasing our costs of doing business and reducing our revenues, and may limit our ability to pursue business opportunities or otherwise adversely affect our business and financial condition. The Dodd-Frank Act and other laws, as well as rules implementing or related to them, may adversely affect us. Specifically, any governmental or regulatory action having the effect of requiring us to obtain additional capital could reduce earnings and have a material dilutive effect on current shareholders, including the Dodd-Frank Act source of strength requirement that bank holding companies make capital infusions into a troubled subsidiary bank. Legislation and regulation of debit card fees, credit cards and other bank services, as well as changes in our practices relating to those and other bank services, may affect our revenue and other financial results. Additional information about increased regulation is provided in "Item 1. Business" under the heading "Supervision and Regulation."

We are also subject to tax laws and regulations promulgated by the United States government and the states in which it operates. Changes to these laws and regulations or the interpretations of such laws and regulations by taxing authorities could impact future tax expense and the value of deferred tax assets.

A new accounting standard will result in a significant change in how we recognize credit losses and may have a material impact on our financial condition or results of operations. ASU 2016-13, "Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." Issued in June 2016, ASU 2016-13 adds Financial Accounting Standards Board "FASB" ASC Topic 326, "Financial Instruments-Credit Losses" and finalizes amendments to FASB ASC Subtopic 825-15, "Financial Instruments-Credit Losses." The amendments of ASU 2016-13 are intended to provide financial statement users with more decision-useful information related to expected credit losses on financial instruments and other commitments to extend credit by replacing the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to determine credit loss estimates.

The amendment requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to enhance their credit loss estimates. The amendment requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this update become effective for annual periods and interim periods within those annual periods beginning after December 15, 2019. Early adoption will be permitted beginning after December 15, 2018.

As previously disclosed, the Company formed a cross functional committee to oversee the adoption of the ASU at the effective date. A working group was also formed and has developed a project plan focused on understanding the ASU, researching issues, identifying data needs for modeling inputs, technology requirements, modeling considerations, and ensuring overarching governance has been achieved for each objective and milestone. The project plan is targeting data and model validation completion during the first half of 2019, with parallel processing of our existing allowance for loan losses model with the CECL for 2 – 3 quarters prior to implementation, depending on how model completion and validation occurs.

During 2019, the Company is focused on the completion of its model, refining assumptions, and continued review and challenge of the model. Concurrent with this, the Company is also focused on researching and resolving interpretive accounting issues in the ASU, contemplating various related accounting policies, developing processes and related controls, and considering various reporting disclosures.

As of the beginning of the first reporting period in which the new standard is effective, the Company expects to recognize a one-time cumulative effect adjustment increasing the allowance for loan losses, if any, since the ASU covers credit losses over the expected life of a loan as well as considering future changes in macroeconomic conditions. The magnitude of any such one-time adjustment or the overall impact of the new guidance on the consolidated financial statements cannot yet be reasonably estimated , however, we expect to identify a range in our Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2019.

In December 2018, the OCC, the Board of Governors of the Federal Reserve System, and the FDIC approved a final rule to address changes to credit loss accounting under GAAP, including banking organizations' implementation of CECL. The final rule provides banking organizations the option to phase in over a three-year period the day-one adverse effects on regulatory capital that may result from the adoption of the new accounting standard.

Deposit insurance premiums levied against the Company may increase if the number of bank failures increase or the cost of resolving failed banks increases. The FDIC maintains a DIF to protect insured depositors in the event of bank failures. The DIF is funded by fees assessed on insured depository institutions including Kentucky Bank. Future deposit premiums paid by Kentucky Bank depend on the level of the DIF and the magnitude and cost of future bank failures. Kentucky Bank may be required to pay significantly higher FDIC premiums if market developments change such that the DIF balance is reduced.

Increased competition from other providers may adversely affect our financial condition and results of operations. We face vigorous competition from banks and other financial institutions. This competition may reduce or limit our margins on banking services, reduce market share and adversely affect results of operations and financial condition.
Many other banks and financial institutions have substantially greater resources and lending limits, larger branch systems and a wider array of banking services.

Additionally, we encounter competition from both de novo and smaller community banks entering the markets we are currently in. We also compete with other providers of financial services, such as money market mutual funds, brokerage firms, consumer finance companies and insurance companies.

Changes in consumer use of banks and changes in consumer spending and saving habits could adversely affect our financial results. Technology and other changes now allow many consumers to complete financial transactions without using banks. For example, consumers can pay bills and transfer funds directly without going through a bank and can access loans through lending groups and other non-regulated entities. This "disintermediation" could result in the loss of fee and interest income, as well as the loss of customer deposits and income generated from those deposits. In addition, changes in consumer spending and saving habits could adversely affect our operations, and we may be unable to timely develop competitive new products and services in response to these changes that are accepted by new and existing customers.

Financial Risk

Financial risk components include, but are not limited to, credit risk, interest rate risk, goodwill impairment, market risk and liquidity risk. We have adopted various policies to minimize potential adverse effects of interest rate, market and liquidity risks. However, even with these policies in place, a change in interest rates could negatively impact our results of operations or financial position.

Defaults in the repayment of loans may negatively impact our business. Credit risk is most closely associated with lending activities at financial institutions. Credit risk is the risk to earnings and capital when a customer fails to meet the terms of any contract or otherwise fails to perform as agreed. Credit risk arises from all activities where the Company is dependent on issuer, borrower, or counterparty performance, not just traditional lending activities. For example, the investment security portfolio has inherent credit risk as do counterparties in derivative contracts. Credit risk encompasses a broad range of financial institution activities and includes items reflected both on and off the balance sheet.

Management makes various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of its borrowers and the value of real estate and other assets serving as collateral for repayment of many of the loans. In determining the size of the allowance for loan losses, management considers, among other factors, the Company's loan loss experience and an evaluation of economic conditions.
If these assumptions prove to be incorrect, the current allowance may not be sufficient to cover future loan losses and adjustments may be necessary to allow for different economic conditions or adverse developments in the loan portfolio. Material additions to the Company's allowance would materially decrease our net income.

Fluctuations in interest rates may negatively impact our banking business. Interest rate risk focuses on the impact to earnings and capital arising from movements in interest rates. Interest rate risk focuses on the value implications for accrual portfolios (e.g., available-for-sale portfolios) and includes the potential impact to the Company's accrual earnings as well as the economic perspective of the market value of portfolio equity. The interest rate risk is comprised of repricing risk, basis risk, yield curve risk and options risk. Repricing risk represents the risk associated with the differences in timing of cash flows and rate changes with our products. Basis risk represents the risk associated with changing rate relationships among varying yield curves. Yield curve risk is associated with changing rate relationships over the maturity structure. Options risk is associated with interest-related options, which are embedded in our products.

Changes in market multiples may negatively affect the value of Goodwill. Goodwill resulting from business combinations prior to January 1, 2009 represents the excess of the purchase price over the fair value of the net assets of businesses acquired. Goodwill resulting from business combinations after January 1, 2009, is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually. The Company has selected December 31 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on our balance sheet. At a minimum, management is required to assess goodwill and other intangible assets annually for impairment. This assessment involves estimating cash flows for future periods, preparing analyses of market multiples for similar operations, and estimating the fair value of the reporting unit to which the goodwill is allocated.

If these variables change negatively, the Company would be required to take a charge against earnings to write down the asset to the lower fair value.

Changes in market factors may negatively affect the value of our investment assets. Market risk focuses on the impact to earnings and capital arising from changes in market factors (e.g., interest rates, market liquidity, volatilities, etc.) that affect the value of traded instruments. Market risk includes items reflected both on and off the balance sheet. Market risk focuses primarily on mark-to-market portfolios (e.g., accounts revalued for financial statement presentation).

Our inability to maintain appropriate levels of liquidity may have a negative impact on our results of operations and financial condition. Liquidity risk focuses on the impact to earnings and capital resulting from our inability to meet our obligations as they become due in the normal course of business without incurring significant losses. It also includes the management of unplanned decreases or changes in funding sources as well as managing changes in market conditions, which could affect the ability to liquidate assets in the normal course of business without incurring significant losses. Liquidity risk includes items both on and off the balance sheet.

Our results of operations and financial condition may be negatively affected if we are unable to meet a debt covenant and, correspondingly, unable to obtain a waiver regarding the debt covenant from the lender. From time to time we may obtain financing from other lenders. The loan documents reflecting the financing often require us to meet various debt covenants. If we are unable to meet one or more of our debt covenants, then we will typically attempt to obtain a waiver from the lender. If the lender does not agree to a waiver, then we will be in default under our borrowing obligation. This default could affect our ability to fund various strategies that we may have implemented resulting in a negative impact in our results of operations and financial condition.

We are exposed to risk of environmental liabilities with respect to properties to which we take title. In the course of our business, we may foreclose and take title to real estate, and could be subject to environmental liabilities with respect to these properties. While we will take steps to mitigate this risk, we may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or we may be required to investigate or clean-up hazardous or toxic substances, or chemical releases at one or more properties. The costs associated with investigation or remediation activities could be substantial. In addition, while there are certain statutory protections afforded lenders who take title to property through foreclosure on a loan, if we are the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If we become subject to significant environmental liabilities, our business, financial condition, results of operations and prospects could be adversely affected.

Business Risk

Business risk is composed mainly of legal (compliance) risk, strategic risk and reputation risk.

Our results of operations and financial condition are susceptible to legal or compliance risks. Legal or compliance risk is the risk to earnings or capital arising from the impact of unenforceable contracts, lawsuits, adverse judgments, violations or nonconformance with laws, rules, regulations, prescribed practices, or ethical standards. The risk also arises in situations where laws or rules governing certain products or activities of our customers may be ambiguous or untested. This risk is not limited to the traditional thinking that legal/compliance risk is only associated with consumer protection laws. It includes the exposure to litigation from all aspects of both traditional and nontraditional financial institution activities.

Incorrect strategic decisions may have a negative impact on our results of operations and financial condition.

Adverse publicity may have a negative impact on our business. Reputation risk is the risk to earnings and capital arising from negative public opinion. This affects the ability to establish new relationships or services or to continue servicing existing relationships. Examiners will assess reputation risk by recognizing the potential effect the public’s opinion could have on our franchise value.

The Tax Cuts and Jobs Act may impact our business in unforeseen ways. On December 22, 2017, legislation commonly known as the Tax Cuts and Jobs Act (the "Tax Reform"), was signed into law. The Tax Reform, among other changes, reduces the U.S. federal corporate income tax rate from 35% to 21%. The enactment of the Tax Reform will significantly impact the manner in which we determine our federal income tax and may have unforeseen consequences. The Tax Reform is the first major overhaul of U.S. corporate taxation in almost 20 years with both positive and negative impacts on our business. The positive impacts include reducing the federal corporate income tax rate from 35% to 21% and accelerating the recovery period of the Company's fixed assets.

These positive impacts are offset by new tax provisions intended to expand the federal tax base by disallowing certain expenses that were previously deductible (i.e. 50% of entertainment expenses, deductions for certain senior management compensation, etc.). It is difficult to determine the overall impact on our business, but it appears that the Company will have a net savings in its federal income tax liability.

The impact of the Tax Reform may also have significant impact on our clients and their future behavior in light of the new tax rates applicable to individuals, trusts and unincorporated businesses. The limitation on the deductibility of state and local taxes and real estate taxes for individuals may result in clients moving to lower tax states where we do not have operations

We are always seeking acquisition opportunities but the acquisitions may not produce revenue enhancements or cost savings at levels or within timeframes originally anticipated and may result in unforeseen integration difficulties and dilution to existing shareholder value.

We have acquired, and expect to continue to acquire, other financial institutions or parts of those institutions in the future, and we may engage in de novo branch expansion. We may also consider and enter into new lines of business or offer new products or services.

We may incur substantial costs to expand, and we can give no assurance such expansion will result in the levels of profits we seek. There can be no assurance that integration efforts for any mergers or acquisitions will be successful. Also, we may issue equity securities in connection with acquisitions, which could cause ownership and economic dilution to our current shareholders. There is no assurance that, following any mergers or acquisitions, our integration efforts will be successful or that, after giving effect to the acquisition, we will achieve profits comparable to, or better than, our historical experience.

We must generally receive federal regulatory approval before we can acquire a bank or bank holding company. We cannot be certain when or if, or on what terms and conditions, any required regulatory approvals will be granted. We may be required to sell branches as a condition to receiving regulatory approval.

Future acquisitions could be material to Kentucky Bancshares and we may issue additional shares of stock to pay for those acquisitions, which would dilute current shareholders' ownership interests.

Operational Risk

Because the nature of the financial services business involves a high volume of transactions, we face significant operational risks. Operational risk is the risk of loss resulting from our operations, including, but not limited to, the risk of fraud by employees or persons outside of the Company, the execution of unauthorized transactions by employees, errors relating to transaction processing and technology, breaches of the internal control system and compliance requirements and business continuation and disaster recovery.
This risk of loss also includes the potential legal actions that could arise as a result of an operational deficiency or as a result of noncompliance with applicable regulatory standards, adverse business decisions or their implementation, and customer attrition due to potential negative publicity.

In the event of a breakdown in the internal control system, improper operation of systems or improper employee actions, we could suffer financial loss, face regulatory action and suffer damage to its reputation.

Technology Risk

Systems failure, interruption or breach of security may have a negative impact on our business. Communications and information systems are essential to the conduct of Kentucky Bank's business, as such systems are used to manage customer relationships, deposits, loans, general ledger accounts, financial reporting and regulatory compliance. While Kentucky Bank has established policies and procedures to prevent or limit the impact of systems failures, interruptions, and security breaches, there can be no assurance that such events will not occur or that they will be adequately addressed if they do.

In addition, any compromise of Kentucky Bank's information security systems could deter customers from using Kentucky Bank's web site and its internet banking service, both of which involve the transmission of confidential information.

Although Kentucky Bank relies on commonly used security and processing systems to provide the security and authentication necessary to ensure the secure transmission and processing of data, these precautions may not protect our systems from all compromises or breaches of security.

The business continuity of third-party providers may have a negative impact on our technology operations. Kentucky Bank outsources certain of its data processing to third-party providers. If third-party providers encounter difficulties, or if the Bank has difficulty communicating with them, Kentucky Bank's ability to adequately process and account for customer transactions could be affected, and its business operations could be adversely impacted. Threats to information security also exist in the processing of customer information through various other vendors and their personnel.

We and our subsidiary bank have addressed technology risks through the use of logon and user access controls, transaction limits, firewalls, antivirus software, intrusion protection monitoring and third party vulnerability scans. Systems failure or interruption has been addressed by adopting a disaster recovery and contingency plan. In addition, for all third-party providers of data processing services, we obtain and review audit reports prepared by independent registered public accounting firms regarding their financial condition and the effectiveness of their internal controls.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Company's corporate headquarters is located at 339 Main Street, Paris, KY 40361, which it owns. The main banking office of Kentucky Bank is located at 401 Main Street, Paris, Kentucky 40361. In addition, Kentucky Bank serves customer needs at 16 other locations. All locations offer a full range of banking services. The Company owns approximately 82,000 square feet of office space and leases approximately 22,000 square feet of office space.

Note 6 to the Company's audited and consolidated financial statements included in Item 8 ("2018 Consolidated Financial Statements and Notes") contains additional information relating to amounts invested in premises and equipment.

Kentucky Bank Banking Offices
Owned
401 Main Street, Paris, KY 40361
2021 South Main Street, Paris, KY 40361
1975 By Pass Road, Winchester, KY 40391
50 North Maple Street, Winchester, KY 40391
144 South KY 7, Sandy Hook, KY 41171
939 US Hwy 27 South, Cynthiana, KY 41031
920 North Main Street, Nicholasville, KY 40356
108 East Main Street, Wilmore, KY 40390
400 West First Street, Morehead, KY 40351
1500 Flemingsburg Road, Morehead, KY 40351
260 Blossom Park Drive, Georgetown, KY 40324
103 West Showalter Drive, Georgetown, KY 40324
520 Marsailles Road, Versailles, KY 40383

Leased

360 East Vine Street, Suite 100, Lexington, KY 40507
1001 Gibson Bay Drive, Suite 101, Richmond, KY 40475
680 Dwight Drive Richmond, KY 40475,
724 West Main Street, Richmond, KY 40475

Item 3. Legal Proceedings

None to report.

PART II

Item 5. Market for Common Equity and Related Stockholder Matters

Market Information

The Company's Common Stock is not listed on any national securities exchange. However, it is traded on OTCQX under the symbol "KTYB". Trading in our common stock is less frequent, with trading done directly by a network of brokers. Any over-the-counter market quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

Holders

As of December 31, 2018 the Company had 5,955,242 shares of Common Stock outstanding and approximately 532 holders of record of its Common Stock.

Dividends

During 2018 and 2017, the Corporation declared quarterly cash dividends aggregating $0.625 and $0.58 per share, respectively. Note 16 to the Company's 2018 Consolidated Financial Statements and Notes included in Item 8 contains additional information relating to amounts available to be paid as dividends.

Purchases of Equity Securities by the Issuer and Affiliates Purchasers

The table below lists issuer purchases of equity securities.

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid Per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans Or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
10/1/18 - 10/31/18	—	$ —	—	201,824 shares
11/1/18 - 11/30/18	—	—	—	201,824 shares
12/1/18 - 12/31/18	—	—	—	201,824 shares
Total	—	$ —	—	201,824 shares

On October 25, 2000, the Company announced that its Board of Directors approved a stock repurchase program. The Company was authorized to purchase up to 200,000 shares of its outstanding common stock. On November 11, 2002, the Board of Directors approved and authorized the Company's repurchase of an additional 200,000 shares. On May 20, 2008, the Board of Directors approved and authorized the purchase of an additional 200,000 shares. On May 17, 2011, the Board of Directors approved and authorized the Company's repurchase of an additional 200,000 shares. On November 18, 2016, the Board of Directors approved and authorized the Company's repurchase of an additional 100,000 shares. Shares will be purchased from time to time in the open market depending on market prices and other considerations.

Through December 31, 2018, 698,176 shares have been purchased, with the most recent share repurchase under the Board-approved stock repurchase program having occurred on January 18, 2017.

All per share data was adjusted for the two-for-one stock split which occurred as of close of business on December 3, 2018. Note 1 to the Company's 2018 Consolidated Financial Statements and Notes included in Item 8 contain additional information pertaining to the Stock Split.

Securities Authorized for Issuance under Equity Compensation Plans

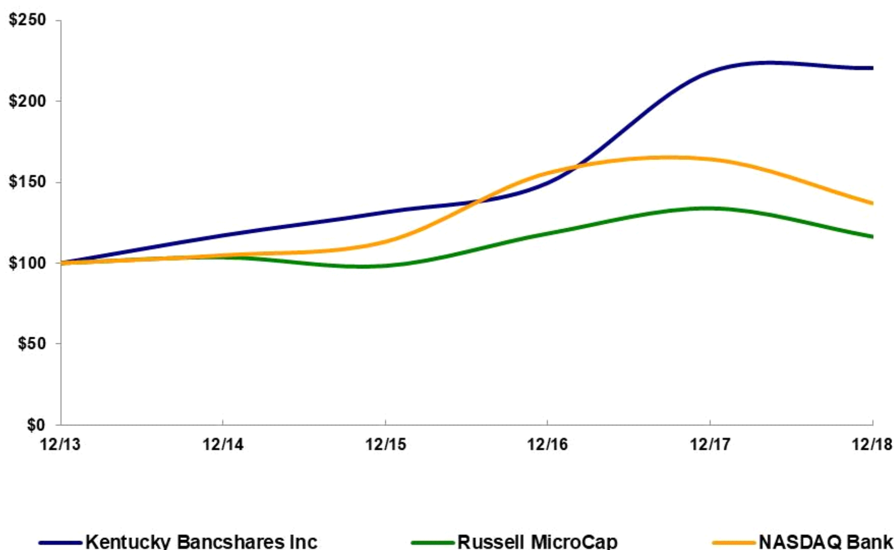
The following table sets forth certain information regarding Company compensations plans under which equity securities of the company are authorized for issuance.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options warrants and rights	No. of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column 1)
Plans Approved By Stockholders:			
2009 Stock Award Plan	—	—	255,846

Performance Graph

The information included under the caption "Performance Graph" in this Item 5 of this Form 10-K is not deemed to be "soliciting material" or to be "filed" with the SEC or subject to Regulation 14A or 14C under the Securities Exchange Act of 1934 or to the liabilities of Section 18 of the Securities Exchange Act of 1934, and will not be deemed to be incorporated by reference into any filings we make under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent we specifically incorporate it by reference into such a filing.

The graph below matches Kentucky Bancshares Inc's cumulative 5-Year total shareholder return on common stock with the cumulative total returns of the Russell MicroCap index and the NASDAQ Bank index. The graph tracks the performance of a $100 investment in our common stock and in each index (with the reinvestment of all dividends) from 12/31/2013 to 12/31/2018.



*$100 invested on 12/31/13 in stock or index, including reinvestment of dividends.
Fiscal year ending December 31.

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	12/13	12/14	12/15	12/16	12/17	12/18
Kentucky Bancshares Inc	**100.00**	**117.16**	**131.50**	**149.63**	**218.17**	**220.55**
Russell MicroCap	**100.00**	**103.65**	**98.30**	**118.32**	**133.90**	**116.39**
NASDAQ Bank	**100.00**	**104.89**	**113.29**	**155.71**	**164.24**	**136.99**

The stock price performance included in this graph is not necessarily indicative of future stock price performance.

Item 6. Selected Financial Data (in thousands except per share data)

The following selected financial data should be read in conjunction with the Company's Consolidated Financial Statements and the accompanying notes presented in Item 8.

	At or For the Year ended December 31,				
	2018	2017	2016	2015	2014
CONDENSED STATEMENT OF INCOME:					
Total Interest Income	$ 42,632	$ 38,659	$ 36,554	$ 33,185	$ 29,731
Total Interest Expense	6,802	5,014	4,426	4,050	3,756
Net Interest Income	35,830	33,645	32,128	29,135	25,975
Provision for Losses	500	500	1,150	1,450	950
Net Interest Income After Provision for Losses	35,330	33,145	30,978	27,685	25,025
Noninterest Income	12,963	13,808	12,149	11,484	10,158
Noninterest Expense	34,209	33,073	33,785	31,807	27,215
Income Before Income Tax Expense	14,084	13,880	9,342	7,362	7,968
Income Tax Expense	1,654	3,163	773	530	897
Net Income	12,430	10,717	8,569	6,832	7,071
SHARE DATA:					
Basic Earnings per Share (EPS)	$ 2.09	$ 1.81	$ 1.43	$ 1.20	$ 1.30
Diluted EPS	2.09	1.81	1.43	1.20	1.30
Cash Dividends Declared	0.625	0.580	0.540	0.520	0.500
Book Value	17.93	16.88	15.64	14.81	14.33
Average Common Shares-Basic	5,957	5,944	5,982	5,646	5,442
Average Common Shares-Diluted	5,957	5,944	5,982	5,646	5,442
SELECTED BALANCE SHEET DATA:					
Loans, net	$ 678,017	$ 640,815	$ 648,466	$ 617,600	$ 532,293
Investment Securities	315,369	318,177	273,770	264,212	246,861
Trading Assets	—	—	5,592	5,531	5,370
Total Assets	1,086,012	1,053,193	1,028,447	974,684	855,209
Deposits	850,442	815,273	802,981	758,981	654,869
Securities sold under agreements to repurchase	8,077	19,900	20,873	18,514	12,457
Federal Home Loan Bank advances	100,452	98,732	92,500	87,833	93,785
Note Payable	2,718	3,321	4,090	4,794	—
Subordinated Debentures	7,217	7,217	7,217	7,217	7,217
Stockholders' Equity	106,793	100,329	92,972	89,413	77,942
PERFORMANCE RATIOS:					
(Average Balances)					
Return on Assets	1.18 %	1.04 %	0.86 %	0.76 %	0.89 %
Return on Stockholders' Equity	12.36 %	10.93 %	9.10 %	8.20 %	9.50 %
Net Interest Margin (1)	3.67 %	3.60 %	3.61 %	3.63 %	3.69 %
Equity to Assets (annual average)	9.56 %	9.48 %	9.41 %	9.25 %	9.34 %
SELECTED STATISTICAL DATA:					
Dividend Payout Ratio	29.96 %	32.16 %	37.68 %	43.20 %	38.48 %
Number of Employees (at period end)	232	233	241	243	215
ALLOWANCE COVERAGE RATIOS:					
Allowance to Total Loans	1.18 %	1.19 %	1.15 %	1.04 %	1.12 %
Net Charge-offs as a Percentage of Average Loans	0.01 %	0.05 %	0.02 %	0.16 %	0.08 %

(1) Tax equivalent

All per share data was adjusted for the two-for-one stock split which occurred as of close of business on December 3, 2018. Note 1 to the Company's 2018 Consolidated Financial Statements and Notes included in Item 8 contain additional information pertaining to the Stock Split.

Item 7. Management's Discussion and Analysis

This section presents an analysis of the consolidated financial condition of the Company and its wholly-owned subsidiary, Kentucky Bank, at December 31, 2018, 2017 and 2016, and the consolidated results of operations for each of the years in the three year period ended December 31, 2018. The following discussion and analysis of financial condition and results of operations should be read in conjunction with the 2018 Consolidated Financial Statements and Notes included in Item 8. When necessary, reclassifications have been made to prior years' data throughout the following discussion and analysis for purposes of comparability with 2018 data.

Critical Accounting Policies

Overview. The accounting and reporting policies of the Company and its subsidiary are in accordance with accounting principles generally accepted in the United States and conform to general practices within the banking industry. Significant accounting policies are listed in Note 1 of the Company's 2018 Consolidated Financial Statements and Notes included in Item 8. Critical accounting and reporting policies include accounting for loans and the allowance for loan losses, goodwill and fair value. Different assumptions in the application of these policies could result in material changes in the consolidated financial position or consolidated results of operations.

Loan Values and Allowance for Loan Losses. Loans are stated at the amount of unpaid principal, reduced by an allowance for loan losses. Interest on loans is recognized on the accrual basis, except for those loans on the nonaccrual status. Interest income received on such loans is accounted for on the cash basis or cost recovery method. The allowance for loan losses is a valuation allowance for probable incurred credit losses. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. The accounting policies relating to the allowance for loan losses involve the use of estimates and require significant judgments to be made by management. The loan portfolio also represents the largest asset group on the consolidated balance sheets. Additional information related to the allowance for loan losses that describes the methodology and risk factors can be found under the captions *"Asset Quality"* and *"Loan Losses"* in this management's discussion and analysis of financial condition and results of operation, as well as Notes 1 and 4 of the Company's 2018 Consolidated Financial Statements and Notes.

Goodwill. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually. The Company has selected December 31 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on our balance sheet.

Fair Values. Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in the description of each asset and liability category in Note 17 of the Company's 2018 Consolidated Financial Statements and Notes. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Forward-Looking Statements

This discussion contains forward-looking statements under the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties. Although the Company believes that the assumptions underlying the forward-looking statements contained herein are reasonable, any of the assumptions could be inaccurate, and therefore, there can be no assurance that the forward-looking statements included herein will prove to be accurate. Factors that could cause actual results to differ from the results discussed in the forward-looking statements include, but are not limited to: economic conditions (both generally and more specifically in the markets, including the tobacco market, the thoroughbred horse industry and the automobile industry relating to Toyota vehicles, in which the Company and its bank operate); competition for the Company's customers from other providers of financial and mortgage services; government legislation, regulation and monetary policy (which changes from time to time and over which the Company has no control); changes in interest rates (both generally and more specifically mortgage interest rates); material unforeseen changes in the liquidity, results of operations, or financial condition of the Company's customers;

and other risks detailed in Part 1, Item 1A "Risk Factors" in this report and other risks detailed in the Company's filings with the Securities and Exchange Commission, all of which are difficult to predict and many of which are beyond the control of the Company. The Company undertakes no obligation to republish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Overview

We conduct our business through our one bank subsidiary, Kentucky Bank, and our one non-bank subsidiary KBI Insurance Company. Kentucky Bank is engaged in general full-service commercial and consumer banking. A significant part of Kentucky Bank's operating activities include originating loans, approximately 83% of which are secured by real estate at December 31, 2018.

Kentucky Bank makes commercial, agricultural and real estate loans to its commercial customers, with emphasis on small-to-medium-sized industrial, service and agricultural businesses. It also makes residential mortgages, installment and other loans to its individual and other non-commercial customers. Kentucky Bank's primary market is Bourbon, Clark, Elliott, Fayette, Harrison, Jessamine, Madison, Rowan, Scott, Woodford and surrounding counties in Kentucky. KBI Insurance Company is a captive insurance subsidiary and was incorporated in 2014.

Net income for the year ended December 31, 2018 was $12.4 million, or $2.09 per common share compared to $10.7 million, or $1.81 for 2017 and $8.6 million, or $1.43 for 2016. Earnings per share assuming dilution were $2.09, $1.81 and $1.43 for 2018, 2017 and 2016, respectively. For 2018, net income increased $1.7 million, or 16.0%. Net interest income increased $2.2 million, provision for loan losses showed no change, total non-interest income decreased $845 thousand, while total other non-interest expense increased $1.1 million and income tax expense decreased $1.5 million.

For 2017, net income increased $2.1 million, or 25.1%. Net interest income increased $1.5 million, the provision for loan losses decreased $650 thousand, total other income increased $1.7 million, while total other expenses decreased $712 thousand and income tax expense increased $2.4 million.

Return on average equity was 12.4% in 2018 compared to 10.9% in 2017 and 9.1% in 2016. Return on average assets was 1.18% in 2018 compared to 1.04% in 2017 and 0.86% in 2016.

Non-performing loans as a percentage of loans (including held for sale) were 0.34%, 0.22% and 1.15% as of December 31, 2018, 2017 and 2016, respectively.

For each share of common stock held as of close of business on December 3, 2019 we completed a two-for-one stock split. Earnings and dividends per share have been adjusted in all periods presented to give effect to all stock splits and dividends through the date of issuance of the financial statements.

RESULTS OF OPERATIONS

Net Interest Income

Net interest income, the Company's largest source of revenue, on a tax equivalent basis increased from $34.0 million in 2016 to $35.4 million in 2017, and to $36.6 million in 2018. The taxable equivalent adjustment (nontaxable interest income on state and municipal obligations net of the related non-deductible portion of interest expense) is based on our Federal income tax rate of 21% in 2018 and 34% in both 2017 and 2016.

Average earning assets increased and average interest bearing liabilities decreased from 2017 to 2018. Average earning assets increased $6.7 million, or 0.7%. Average investment securities increased $2.1 million and average loans increased $17.9 million. Average interest bearing liabilities decreased $2.7 million, or 0.4% during this same period. Average interest-bearing deposits increased $6.2 million, or 1.1%, average borrowings from the Federal Home Loan Bank increased $2.9 million, or 3.0 %, and average repurchase agreements and other borrowings decreased $11.8 million, or 34.3%. The Company continues to actively pursue quality loans and fund these primarily with deposits and Federal Home Loan Bank advances.

The bank prime rates increased 100 basis points from December 2017 to December 2018. The tax equivalent yield on earning assets increased from 4.11% in 2017 to 4.39% in 2018.

The volume rate analysis for 2018 that follows indicates that $910 thousand of the increase in interest income is attributable to an increase in volume, while the change in rates contributed to an increase of $3.1 million in interest income. Further, a decrease in interest bearing liabilities resulted in a $514 thousand reduction interest expense in 2018 compared to 2017 while changes in rates resulted in additional interest expense of $2.3 million over the same period. The average rate of these liabilities increased from 0.70% in 2017 to 0.95% in 2018. In summary, the increase in the Company's 2018 net interest income is attributed mostly to increases in rates for interest earning assets and an increase in balances in our loan portfolio.

The volume rate analysis for 2017 that follows indicates that $985 thousand of the increase in interest income is attributable to an increase in volume, while the change in rates contributed to a decrease of $1.1 million in interest income. Further, an increase in interest bearing liabilities resulted in $35 thousand additional interest expense in 2017 compared to 2016 while changes in rates resulted in additional interest expense of $553 thousand over the same period. The average rate of these liabilities increased from 0.64% in 2016 to 0.70% in 2017. In summary, the increase in the Company's 2017 net interest income is attributed mostly to increases in rates for interest earning assets and an increase in balances in our security portfolio.

The accompanying analysis of changes in net interest income in the following table shows the relationships of the volume and rate portions of these changes in 2018 vs. 2017 and 2017 vs. 2016. Changes in interest income and expenses due to both rate and volume are allocated on a pro rata basis.

Changes in Interest Income and Expense (in thousands)

	2018 vs. 2017			2017 vs. 2016		
	Increase (Decrease) Due to Change in			Increase (Decrease) Due to Change in		
	Volume	Rate	Net Change	Volume	Rate	Net Change
INTEREST INCOME						
Loans	$ 869	$ 2,276	$ 3,145	$ 190	$ 728	$ 918
Investment Securities	94	621	715	769	352	1,121
Other	(53)	166	113	26	40	66
Total Interest Income	910	3,063	3,973	985	1,120	2,105
INTEREST EXPENSE						
Deposits						
Demand	15	980	995	36	329	365
Savings	—	7	7	9	(13)	(4)
Negotiable Certificates of Deposit and Other Time Deposits	(50)	595	545	(37)	159	122
Securities sold under agreements to repurchase and other borrowings	(532)	560	28	(21)	49	28
Federal Home Loan Bank advances	53	160	213	48	29	77
Total Interest Expense	(514)	2,302	1,788	35	553	588
Net Interest Income	$ 1,424	$ 761	$ 2,185	$ 950	$ 567	$ 1,517

Average Consolidated Balance Sheets and Net Interest Income Analysis ($ in thousands)

	2018			2017			2016		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
ASSETS									
Interest-Earning Assets									
Securities Available for Sale (1)									
U.S. Treasury and Federal Agency Securities	$ 227,793	$ 5,537	2.43 %	$ 201,719	$ 4,287	2.13 %	$ 172,632	$ 3,201	1.85 %
State and Municipal obligations	76,580	2,308	3.01	93,204	2,738	2.94	90,265	2,772	3.07
Equity Securities	—	—	—	320	6	4.87	320	7	3.93
Total Investment Securities	304,373	7,845	2.58	302,277	7,031	2.44	270,251	5,980	2.32
Tax Equivalent Adjustment		475	0.16		1,142	0.38		1,242	0.46
Tax Equivalent Total	304,373	8,320	2.73	302,277	8,173	2.82	270,251	7,222	2.78
Federal Home Loan Bank Stock and Other	7,305	419	5.74	7,034	352	5.00	7034	282	4.01
Trading Assets	—	—	—	5,469	108	1.97	5,625	153	2.72
Tax Equivalent Adjustment		—	—		49	0.90		75	1.33
Tax Equivalent Total	—	—	—	5,469	157	2.87	5,625	228	4.05
Federal Funds Sold and Agreements to Repurchase	2,165	32	1.48	889	6	0.67	1,086	3	0.28
Interest-Bearing Deposits with Banks	15,192	273	1.80	24,262	244	1.01	20,403	136	0.67
Loans, Net of Deferred Loan Fees (2)									
Commercial	88,294	4,082	4.62	85,318	3,498	4.10	77,284	2,970	3.84
Real Estate Mortgage	561,121	28,624	5.10	547,494	26,011	4.75	551,413	25,645	4.65
Consumer	18,726	1,357	7.25	17,421	1,409	8.09	17,470	1,385	7.93
Total Loans	668,141	34,063	5.10	650,233	30,918	4.75	646,167	30,000	4.64
Tax Equivalent Adjustment		312	0.05		588	0.09		574	0.09
Tax Equivalent Total	668,141	34,375	5.14	650,233	31,506	4.85	646,167	30,574	4.73
Total Interest-Earning Assets	989,871	42,632	4.31	983,130	38,659	3.93	943,532	36,554	3.87
Tax Equivalent Adjustment		787	0.08		1,779	0.18		1,891	0.20
Tax Equivalent Total	989,871	43,419	4.39	983,130	40,438	4.11	943,532	38,445	4.07
Allowance for Loan Losses	(8,090)			(7,927)			(7,244)		
Cash and Due From Banks	13,211			9,948			12,230		
Premises and Equipment	17,416			15,802			16,296		
Other Assets	39,470			33,773			35,478		
Total Assets	$1,051,878			$1,034,726			$1,000,292		
LIABILITIES									
Interest-Bearing Deposits									
Negotiable Order of Withdrawal (" NOW") and Money Market Investment Accounts	$ 295,616	$ 2,110	0.71 %	$ 285,919	$ 1,040	0.36 %	$ 272,286	$ 675	0.25 %
Savings	111,882	92	0.08	100,391	83	0.08	90,907	84	0.09
Certificates of Deposit and Other Deposits	182,967	2,039	1.11	197,914	1,571	0.73	202,924	1,452	0.72
Total Interest-Bearing Deposits	590,465	4,241	0.72	584,224	2,694	0.46	566,117	2,211	0.39
Securities sold under agreements to repurchase and other borrowings	22,721	651	2.87	34,600	623	1.80	35,844	595	1.66
Federal Home Loan Bank advances	99,462	1,910	1.92	96,524	1,697	1.76	93,818	1,620	1.73
Total Interest-Bearing Liabilities	712,648	6,802	0.95	715,348	5,014	0.70	695,779	4,426	0.64
Noninterest-Bearing Earning Demand Deposits	232,479			213,921			201,395		
Other Liabilities	6,172			7,415			8,957		
Total Liabilities	951,299			936,684			906,131		
STOCKHOLDERS' EQUITY	100,579			98,042			94,161		
Total Liabilities and Stockholders' Equity	$1,051,878			$1,034,726			$1,000,292		
Average Equity to Average Total Assets	9.56 %			9.48 %			9.41 %		
Net Interest Income		35,830			33,645			32,128	
Net Interest Income (tax equivalent) (3)		36,617			35,424			34,019	
Net Interest Spread (tax equivalent) (3)			3.43			3.41			3.44
Net Interest Margin (tax equivalent) (3)			3.70			3.60			3.61

(1) Averages computed at amortized cost.

(2) Includes loans on a nonaccrual status and loans held for sale

(3) Tax equivalent difference represents the nontaxable interest income on state and municipal securities net of the related non-deductible portion of interest expense.

Noninterest Income and Expenses

Noninterest income was $13.0 million in 2018, $13.8 million in 2017 and $12.1 million in 2016. In 2018, reductions in gains on available for sale securities and gains on the sale of loans were offset by gains in service charges and debit card interchange income. In 2017, reductions in gains on available for sale securities and gains on the sale of loans were offset by gains in service charges, loan servicing fee income, debit card interchange income and a one-time gain on the sale of a bank building. In 2016, reductions in net loan servicing fee income, gains on available for sale securities and other income were offset by gains in service charges, gains on the sale of loans and debit card interchange income.

Securities gains (losses) were $(65) thousand in 2018, $52 thousand in 2017 and $287 thousand in 2016. The gains are primarily attributed to selling securities which had gains in market value due to declining interest rates and the related inverse relationship of interest rates and market values.

Gains on loans sold were $1.6 million, $1.7 million and $2.1 million in 2018, 2017 and 2016, respectively. Loans held for sale are generally sold after closing to the Federal Home Loan Mortgage Corporation or other government agencies. During 2018, the loan servicing fee income, net of amortization expense for the mortgage servicing right asset, decreased $82 thousand, compared to an increase of $244 thousand in 2017. In 2018, the mortgage servicing right asset had net recoveries of prior write-downs of $17 thousand compared to net recoveries of $69 thousand in the valuation allowance in 2017. Proceeds from the sale of loans were $64 million, $58 million and $64 million in 2018, 2017 and 2016, respectively. The volume of loan originations is inverse to rate changes with historic low rates spurring activity. The volume of loan originations during 2018 was $63 million, $57 million in 2017, and $62 million in 2016.

Other noninterest income, excluding net security gains (losses), the sale of mortgage loans and a one-time gain of $1.2 million for the sale of a building in 2017, was $11.5 million in 2018, $10.8 million in 2017 and $9.8 million in 2016. Service charge income, and more particularly overdraft income, is the largest contributor to these numbers. Overdraft income was $2.6 million in 2018, $2.6 million in 2017 and $2.7 million in 2016. Debit card interchange income was the second largest contributor to noninterest income. Debit card interchange income was $3.3 million in 2018, $3.0 million in 2017 and $2.7 million in 2016. Other income was $430 thousand in 2018, $349 thousand in 2017 and $95 thousand in 2016.

Noninterest expense increased $1.1 million in 2018 to $34.2 million, and decreased $712 thousand in 2017 to $33.1 million from $33.8 million in 2016.

Salaries and benefits, the largest contributor to total non-interest expense, increased $936 thousand from $18.0 million in 2017 to $18.9 million in 2018 due to normal staff merit increases. Full-time equivalent employees decreased from 233 at December 31, 2017 to 232 at December 31, 2018.

The largest component of occupancy expense, depreciation expense, increased $39 thousand to $1.2 million in 2018, and decreased $104 thousand to $1.2 million in 2017. Building rent expense, included in occupancy expense, increased $10 thousand from 2017 to 2018, mostly due to additional space leased at the Lexington Vine branch.

Other noninterest expenses decreased from $12.1 million in 2016 to $11.3 million in 2017 and was unchanged at $11.3 million in 2018. Legal and professional fees decreased $174 thousand from $1.1 million in 2017 to $908 thousand in 2018. Legal and professional fees were higher in 2017 due to additional costs related to utilizing additional outside consulting services. Amortization expense of core deposits was $130 thousand in 2018, $160 thousand in 2017 and $247 thousand in 2016. See Note 7 in the Company's Consolidated Financial Statements and Notes included in Item 8 for more detail of the goodwill and intangible assets.

The following table is a summary of noninterest income and expense for the three-year period indicated.

	For the Year ended December 31, (in thousands)		
	2018	2017	2016
NON-INTEREST INCOME			
Service Charges	$ 5,266	$ 5,113	$ 5,086
Loan Service Fee Income (Loss), net	233	315	71
Trust Department Income	1,348	1,183	1,086
Investment Securities Gains (Losses),net	(65)	52	287
Gains on trading assets	—	6	(92)
Gains on Sale of Mortgage Loans	1,560	1,727	2,098
Brokerage Income	665	818	778
Debit Card Interchange Income	3,273	3,045	2,740
Gain on Sale of Bank Premises and Equipment	(9)	1,200	—
Income from Bank-Owned Life Insurance	262	—	—
Other	430	349	95
Total Non-interest Income	$ 12,963	$ 13,808	$ 12,149
NON-INTEREST EXPENSE			
Salaries and Employee Benefits	$ 18,938	$ 18,002	$ 17,930
Occupancy Expense	3,944	3,773	3,772
Other	11,327	11,298	12,083
Total Non-interest Expense	$ 34,209	$ 33,073	$ 33,785
Net Non-interest Expense as a Percentage of Average Assets	2.02 %	1.86 %	2.16 %

Income Taxes

As part of normal business, Kentucky Bank typically makes tax free loans to select municipalities in our market and invests in selected tax free securities, primarily in the Commonwealth of Kentucky. In making these investments, the Company considers the overall impact to managing our net interest margin, credit worthiness of the underlying issuer and the favorable impact on our tax position. For the year ended December 31, 2018, the Company averaged $60.1 million in tax free securities, and $38.2 million in tax free loans. For the year ended December 31, 2016, the Company averaged $81.1 million in tax free securities, $2.5 million in tax free trading assets and $39.3 million in tax free loans. As of December 31, 2018, the weighted average remaining maturity for the tax free securities is 115 months, while the weighted average remaining maturity for the tax free loans is 149 months.

The Company had income tax expense of $1.7 million in 2018, $3.2 million in 2017 and $773 thousand in 2016. This represents an effective income tax rate of 11.7% in 2018, 22.8% in 2017 and 8.3% in 2016. The difference between the effective tax rate and the statutory federal rate of 21% in 2018 and 34% in both 2017 and 2016 is primarily due to tax exempt income on certain investment securities and loans. On December 22, 2017, the ‘Tax Cuts and Jobs Act’ was enacted into legislation. Under ASC 740, the effects of changes in tax rates and laws were recognized in the period in which the new legislation was enacted. Accordingly,in 2017, the Company recorded an estimated $443 thousand for the revaluation of the Company’s deferred tax assets to estimate the revaluation of deferred tax assets due to the lowering of the federal corporate tax rate to 21%.

In addition, the Company had additional tax credits which also contributed to the lower effective income tax rates. For both 2018 and 2017, the Company had tax credits totaling $555 thousand for investments made in affordable housing project investments.

Balance Sheet Review

Assets remained steady at $1.1 billion from December 31, 2017 to December 31, 2018. Securities available for sale decreased $2.8 million during 2018, outstanding loan balances increased $37.6 million during 2018 and deposits increased $35.2 million during 2018. Assets at year-end 2017 totaled $1.1 billion compared to $1.0 million in 2016. Securities available for sale increased $44 million, outstanding loan balances decreased $7.5 million and deposits increased $12 million compared to 2016.

Loans

Total loans (including loans held for sale) were $687 million at December 31, 2018 compared to $650 million at December 31, 2017 and $657 million at December 31, 2016. As of December 31, 2018 and compared to the prior year-end, commercial loans increased $6.1 million, real estate construction loans increased $3.4 million, 1-4 family residential property loans increased $14.2 million, multi-family residential property loans increased $6.5 million, non-farm & non-residential property loans increased $4.6 million, agricultural loans increased $873 thousand and consumer loans and other loans increased $1.9 million.

As of December 31, 2017 and compared to the prior year-end, commercial loans increased $2.6 million, real estate construction loans decreased $8.4 million, 1-4 family residential property loans decreased $6.0 million, multi-family residential property loans decreased $7.3 million, non-farm & non-residential property loans increased $16.1 million, agricultural loans decreased $3.3 million and consumer loans and other loans decreased $698 thousand.

As of both December 31, 2018 and December 31, 2017, the real estate mortgage portfolio comprised 83% and 81% of total loans, respectively The real estate mortage portfolio is comprised of real estate construction, 1-4 family residential, multi-family residential, non-farm and non-residential and agricultural loans.

1-4 family residential represented 37% of the total loan portfolio as of both December 31, 2018 and 2017. Real estate constructions loans accounted for 4% of the total loan portfolio as of December 31, 2018 and 3% of the total loan portfolio as of December 31, 2017. Multi-family loans represented 7% of the total loan portfolio as of December 31, 2018 and 6% as of December 31, 2017 Non-farm and non-residential loans totaled 29% of the total loan portfolio as of December 31, 2018 and 30% of the total loan portfolio as of December 31, 2017.

Agricultural loans comprised 9% of the total loan portfolio at both December 31, 2018 and at December 31, 2017. Approximately 87% of the agricultural loans are secured by real estate at December 31, 2018 and 88% at December 31, 2017. The remainder of the agricultural portfolio is used to purchase livestock, equipment and other capital improvements and for general operation of the farm. Generally, a secured interest is obtained in the capital assets, equipment, livestock or crops.

Automobile loans account for 16%, in 2018 and 18% in 2017, of the consumer loan portfolio, while the purpose of the remainder of this portfolio is used by customers for purchasing retail goods, home improvement or other personal reasons. The commercial loan portfolio is mainly for capital outlays and business operation.

Collateral is requested depending on the creditworthiness of the borrower. Unsecured loans are made to individuals or companies mainly based on the creditworthiness of the customer. Approximately 8% of the loan portfolio is unsecured. Management is not aware of any significant concentrations that may cause future material risks, which may result in significant problems with future income and capital requirements.

The following table represents a summary of the Company's loan portfolio by category for each of the last five years. There is no concentration of loans (greater than 5% of the loan portfolio) in any industry. The Company has no foreign loans or highly leveraged transactions in its loan portfolio.

	December 31, (in thousands)				
Loans Outstanding	**2018**	**2017**	**2016**	**2015**	**2014**
Commercial	$ 86,149	$ 80,070	$ 77,436	$ 55,929	$ 47,185
Real Estate Construction	24,254	20,816	29,169	29,320	16,938
Real Estate Mortgage:					
1-4 Family Residential	253,797	239,672	245,674	231,479	190,357
Multi-Family Residential	46,403	39,926	47,199	38,281	34,415
Non-Farm & Non-Residential	196,674	192,074	176,024	183,692	161,822
Agricultural	60,049	59,176	62,491	66,782	71,345
Consumer	20,089	18,182	18,867	18,880	16,863
Other	208	170	183	516	279
Total Loans	687,623	650,086	657,043	624,879	539,204
Less Deferred Loan Fees	276	320	312	134	123
Total Loans, Net of Deferred Loan Fees	687,347	649,766	656,731	624,745	539,081
Less loans held for sale	1,203	1,231	724	624	776
Less Allowance for Loan Losses	8,127	7,720	7,541	6,521	6,012
Net Loans	$ 678,017	$ 640,815	$ 648,466	$ 617,600	$ 532,293

The following table sets forth the maturity distribution and interest sensitivity of selected loan categories at December 31, 2018. Maturities are based upon contractual term. The total loans in this report represent loans net of deferred loan fees, including loans held for sale but excluding the allowance for loan losses. In addition, deferred loan fees on the above table are netted with real estate mortgage loans on the following table.

	December 31, 2018 (in thousands)			
Loan Maturities and Interest Sensitivity	**One Year or Less**	**One Through Five Years**	**Over Five Years**	**Total Loans**
Commercial	$ 41,682	$ 24,337	$ 20,130	$ 86,149
Real Estate Construction	19,399	1,715	3,140	24,254
Real Estate Mortgage:				
1-4 Family Residential	98,618	108,638	46,265	253,521
Multi-Family Residential	7,990	32,718	5,695	46,403
Non-Farm & Non-Residential	39,419	100,030	57,225	196,674
Agricultural	19,813	38,018	2,218	60,049
Consumer	6,191	13,268	630	20,089
Other	208	—	—	208
Total Loans, Net of Deferred Loan Fees	233,320	318,724	135,303	687,347
Fixed Rate Loans	12,447	46,650	127,369	186,466
Floating Rate Loans	220,873	272,074	7,934	500,881
Total Loans, Net of Deferred Loan Fees	$ 233,320	$ 318,724	$ 135,303	$ 687,347

Mortgage Banking

The Company has been in mortgage banking since the early 1980's. The activity in origination and sale of these loans fluctuates, mainly due to changes in interest rates. Mortgage loan originations decreased from $62 million in 2016 to $57 million in 2017, and increased to $63 million in 2018. Proceeds from the sale of loans were $64 million, $58 million and $64 million for the years 2016, 2017 and 2018, respectively.
Mortgage loans held for sale were $1.2 million at both December 31, 2018 and December 31, 2017. Fixed rate residential mortgage loans are generally sold when they are made. The volume of loan originations is inverse to rate changes.

During 2018, rising mortgage rates and fewer consumers refinancing mortgages resulted in the Bank originating fewer mortgage loans when compared to 2017. The effect of these changes was also reflected on the income statement. As a result, the gain on sale of loans was $1.6 million in 2018 compared to $1.7 million in 2017 and $2.1 million in 2016.

The Bank has sold various loans to the Federal Home Loan Mortgage Corporation (FHLMC) and the Federal Home Loan Bank (FHLB) while retaining the servicing rights. Gains and losses on loan sales are recorded at the time of the cash sale, which represents the premium or discount paid by the FHLMC and FHLB. The Bank receives a servicing fee from the FHLMC and FHLB on each loan sold. Servicing rights are carried using the amortized cost method and are capitalized based on the relative fair value of the rights and the expected life of the loan and are expensed in proportion to, and over the period of, estimated net servicing revenues.

Mortgage servicing rights were $1.5 million at December 31, 2018, $1.5 million at December 31, 2017 and $1.3 million at December 31, 2016.

Amortization of mortgage servicing rights was $310 thousand (including $17 thousand for positive fair value adjustments), $246 thousand (including $69 thousand for positive fair value adjustments) and $439 thousand (including $105 thousand for negative fair value adjustments) for the years ended December 31, 2018, 2017 and 2016, respectively. See Note 4 in the Company's 2018 Consolidated Financial Statements and Notes included in Item 8 for additional information.

Deposits

For 2018, total deposits increased $35.2 million to $850.4 million. Noninterest bearing deposits increased $1.2 million, time deposits of $250 thousand and over decreased $19.8 million, and other interest bearing deposits increased $53.8 million. Public fund balances totaled $207 million at December 31, 2018, of which $205 million was interest bearing.

For 2017, total deposits increased $12 million to $815 million. Noninterest bearing deposits increased $11 million, time deposits of $250 thousand and over increased $5 million, and other interest bearing deposits decreased $4 million. Public fund balances totaled $192 million at December 31, 2017, of which $187 million was interest bearing.

The table below provides information on the maturities of time deposits of $100,000 or more at December 31, 2018:

Maturity of Time Deposits of $100,000 or More	At December 31, 2018 (in thousands)
Maturing 3 Months or Less	$ 34,215
Maturing over 3 Months through 6 Months	29,034
Maturing over 6 Months through 12 Months	20,908
Maturing over 12 Months	25,613
Total	$ 109,770

Borrowings

The Company utilizes both long-term and short-term borrowings. Long-term borrowing at the Bank is primarily from the Federal Home Loan Bank (FHLB). This borrowing is mainly used to fund longer term, fixed rate mortgages, as part of a leverage strategy and to assist in asset/liability management. Advances are either paid monthly or at maturity. As of December 31, 2018, $100.5 million was borrowed from FHLB, an increase of $1.7 million from December 31, 2017.

Throughout 2018, the Bank had a net increase of $3.2 million in short-term borrowings from the FHLB which were outstanding at December 31, 2018. As of December 31, 2017, $8.4 million in short-term borrowings from the FHLB were outstanding. FHLB advances classified as short-term have an original maturity of less than 1 year.
Also, during 2018, the Bank borrowed $16.4 million in long-term advances and repaid $17.9 million in long term advances. These advances each had an original maturity of more than 1 year.

Throughout 2017, the Bank had a net increase of $8.4 million in short-term borrowings from the FHLB which were outstanding at December 31, 2017. As of December 31, 2016, no short-term borrowings from the FHLB were outstanding. During 2017, the Bank borrowed $13.0 million in longer-term advances and repaid $15.2 million in long term advances. Those advances each had an original maturity of more than 1 year.

On July 20, 2015, the Company borrowed $5.0 million which had an outstanding balance of $2.7 million at December 31, 2018. The term loan has a fixed interest rate of 5.0%, requires quarterly principal and interest payments, matures July 20, 2025 and is collateralized by Kentucky Bank stock. Additional information pertaining to the note payable may be found in Note 10 of the financial statements.

The following table depicts relevant information concerning our short term borrowings.

Short Term Borrowings	As of and for the year ended December 31, (in thousands) 2018	2017	2016
Federal Funds Purchased:			
Balance at Year end	$ —	$ —	$ —
Average Balance During the Year	3,159	1,658	515
Maximum Month End Balance	17,857	17,302	10,517
Year end rate	—	—	—
Average annual rate	2.28 %	1.21 %	0.81 %
Repurchase Agreements:			
Balance at Year end	$ 8,077	$19,900	$20,873
Average Balance During the Year	9,313	21,989	23,755
Maximum Month End Balance	9,751	24,070	27,214
Year end rate	0.60 %	0.52 %	0.50 %
Average annual rate	0.67 %	0.47 %	0.45 %
Federal Home Loan Bank Advances:			
Balance at Year end	$11,600	$ 8,400	$ —
Average Balance During the Year	10,734	1,887	—
Maximum Month End Balance	31,900	8,400	—
Year end rate	2.57 %	1.25 %	—
Average annual rate	2.08 %	1.25 %	—

Contractual Obligations

The Bank has required future payments for time deposits and long-term debt. The other required payments are the approximate future minimum lease payments due under the aforementioned operating leases for their base term and are as follows:

	Payments due by period (in thousands)				
Contractual Obligations	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Federal Home Loan Bank advances	$ 100,452	$ 28,132	$ 34,994	$ 27,947	$ 9,379
Note payable	2,718	513	1,106	1,099	—
Subordinated debentures	7,217	—	—	—	7,217
Time deposits	191,998	136,121	41,964	13,910	3
Lease payments on premises	3,458	423	806	612	1,617

Asset Quality

With respect to asset quality, management considers three categories of assets to merit close scrutiny. These categories include: loans that are currently nonperforming, other real estate, and loans that are currently performing but which management believes require special attention.

During periods of economic slowdown, the Company may experience an increase in nonperforming loans.

The Company discontinues the accrual of interest on loans that become 90 days past due as to principal or interest unless reasons for delinquency are documented such as the loan being well collateralized and in the process of collection. A loan remains in a non-accrual status until factors indicating doubtful collection no longer exist. A loan is classified as a restructured loan when the interest rate is materially reduced or the term is extended beyond the original maturity date because of the inability of the borrower to service the interest payments at market rates. Other real estate is recorded at fair value less estimated costs to sell.

A summary of the components of nonperforming assets, including several ratios using period-end data, is shown as follows.

	At December 31,				
Nonperforming Assets	**2018**	**2017**	**2016**	**2015**	**2014**
Non-accrual Loans	$ 1,141	$ 1,193	$ 4,566	$ 6,351	$ 6,577
Accruing Loans which are Contractually past due over 89 days and still accruing	1,182	231	927	1,000	24
Restructured Loans	—	—	2,063	2,245	6,138
Total Nonperforming Loans	2,323	1,424	7,556	9,596	12,739
Other Real Estate	830	2,404	1,824	2,347	4,604
Total Nonperforming Assets	$ 3,153	$ 3,828	$ 9,380	$ 11,943	$ 17,343
Total Nonperforming Loans as a Percentage of Loans (including loans held for sale) (1)	0.34 %	0.22 %	1.15 %	1.54 %	2.36 %
Total Nonperforming Assets as a Percentage of Total Assets	0.29 %	0.36 %	0.91 %	1.23 %	2.03 %
Allowance As a Percentage of nonperforming assets	258 %	202 %	80 %	55 %	35 %

(1) Net of deferred loan fees

Total nonperforming assets at December 31, 2018 were $3.2 million compared to $3.8 million at December 31, 2017 and $9.4 million at December 31, 2016. The decrease from 2017 to 2018 is mostly attributed to decreases in other real estate. The decrease from 2016 to 2017 is attributed to decreases in non-accrual loan balances and restructured loans. Total other real estate properties totaled $830 thousand at December 31, 2018, of which, $464 thousand were income producing property. Total nonperforming loans were $2.3 million, $1.4 million, and $7.6 million at December 31, 2018, 2017 and 2016, respectively. The decrease in restructured loans during 2017 is attributed to restructured loans with a balance at December 31, 2016 paying off during 2017. No restructured notes were held in 2018. Total net loan charge offs in 2018 were $93 thousand. The amount of lost interest on our non-accrual loans was $108 thousand for 2018 and $46 thousand for 2017. At December 31, 2018, loans currently performing but which management believes requires special attention were $16.5 million, with 48% being non-farm and non-residential, 23% being agriculturual, 16% being 1-4 family residential, 7% being multi-family and 6% being commercial. The Company continues to follow its long-standing policy of not engaging in international lending and not concentrating lending activity in any one industry.

The carrying amount of impaired loans as of December 31, 2018 was $993 thousand compared to $183 thousand as of December 31, 2017. These amounts are generally included in the total nonperforming and restructured loans presented in the table above. See Note 17 in the Company's 2018 Consolidated Financial Statements and Notes included in Item 8 herein.

A loan is considered impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. All amounts due according to the contractual terms means that both the contractual interest payments and the contractual principal payments of a loan will be collected as scheduled in the loan agreement.

Nonaccrual loans are loans for which payments in full of principal or interest is not expected or which principal or interest has been in default for a period of 90 days or more unless the asset is both well secured and in the process of collection. Impaired loans may be loans showing signs of weakness or interruptions in cash flow, but ultimately are current or less than 90 days past due with respect to principal and interest and for which we anticipate full payment of principal and interest through collateral liquidation.

Additional factors considered by management in determining impairment and non-accrual status include payment status, collateral value, availability of current financial information, and the probability of collecting all contractual principal and interest payments.

At December 31, 2018, loans individually evaluated for impairment totaled $4.9 million. Of this, $201 thousand in balances had specific impairment allocations of $201 thousand. The remaining $4.7 million in impaired loan balances did not have a specific impairment allocation.

At December 31, 2017, impaired loan balances of $206 thousand had specific impairment allocations of $23 thousand. An additional $1.4 million in loan balances were individually reviewed for impairment but resulted in no specific impairment allocation.

The allowance for loan losses on impaired loans is determined using one of two methods. Either the present value of estimated future cash flows of the loan, discounted at the loan's effective interest rate or the fair value of the underlying collateral. The entire change in present value of expected cash flows is reported as a provision for loan losses in the same manner in which impairment initially was recognized or as a reduction in the amount of provision for loan losses that otherwise would be reported. The total allowance for loan losses related to these loans was $201 thousand, $23 thousand and $541 thousand on December 31, 2018, 2017 and 2016, respectively.

Kentucky Bank has a "Problem Loan Committee" that meets at least quarterly to review problem loans, including past due and non-performing loans, and other real estate. When analyzing the problem loans and the loan quality as of December 31, 2018, the following factors have been considered:

- Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off and recovery practices not considered elsewhere in estimating credit losses.
- Change in international, national, regional and local economic and business conditions and developments that affect the collectability of the portfolio, including the condition of various market segments.
- Changes in the nature and volume of the portfolio and in the terms of loans.
- Changes in the experience, ability and depth of lending management and other relevant staff.
- Changes in the volume and severity of past due loans; the volume of non-accrual loans, and the volume and severity of adversely classified or graded loans.
- Changes in the quality of the Bank's loan review system.
- Changes in the value of underlying collateral for collateral-dependent loans.
- The existence and effect of any concentrations of credit, and changes in the level of such concentrations.
- The effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the Bank's existing portfolio.

Loan Losses

The following table is a summary of the Company's loan loss experience for each of the past five years.

	For the Year ended December 31, (in thousands)				
	2018	2017	2016	2015	2014
Balance at Beginning of Year	$ 7,720	$ 7,541	$ 6,521	$ 6,012	$ 5,441
Amounts Charged-off:					
Commercial	(23)	(35)	(5)	(30)	(258)
Real Estate Construction	—	—	—	—	—
Real Estate Mortgage:					
1-4 Family Residential	(98)	(249)	(126)	(284)	(274)
Multi-Family Residential	—	—	—	(94)	(42)
Non-Farm & Non-Residential	(31)	(42)	—	—	—
Agricultural	—	—	(193)	(242)	(8)
Consumer and other	(1,108)	(1,076)	(1,206)	(1,300)	(758)
Total Charged-off Loans	(1,260)	(1,402)	(1,530)	(1,950)	(1,340)
Recoveries on Amounts Previously Charged-off:					
Commercial	10	19	39	—	—
Real Estate Construction	—	1	15	11	14
Real Estate Mortgage					
1-4 Family Residential	272	20	19	33	59
Multi-Family Residential	10	181	12	30	57
Non-Farm & Non-Residential	—	—	454	86	368
Agricultural	191	57	50	23	27
Consumer and other	684	803	811	826	436
Total Recoveries	1,167	1,081	1,400	1,009	961
Net Charge-offs	(93)	(321)	(130)	(941)	(379)
Provision for Loan Losses	500	500	1,150	1,450	950
Balance at End of Year	8,127	7,720	7,541	6,521	6,012
Total Loans (1)					
Average	670,063	651,668	647,278	574,141	494,966
At December 31	687,347	649,766	656,731	624,745	539,081
As a Percentage of Average Loans (1):					
Net Charge-offs	0.01 %	0.05 %	0.02 %	0.16 %	0.08 %
Provision for Loan Losses	0.07 %	0.08 %	0.18 %	0.25 %	0.19 %
Allowance as a Percentage of Year-end Loans (1)	1.18 %	1.19 %	1.15 %	1.04 %	1.12 %
Beginning Allowance as a Multiple of Net Charge-offs	83.0	23.5	50.2	6.4	14.4
Ending Allowance as a Multiple of Nonperforming Assets	2.58	2.02	0.80	0.55	0.35

(1) Net of deferred loan fees and includes loans held for sale

Loans are typically charged-off when the collection of principal is considered doubtful, and would be well documented and approved by the appropriate responsible party or committee. The provision for loan losses for 2018 was $500 thousand compared to $500 thousand in 2017 and $1.2 million in 2016. Net charge-offs were $93 thousand in 2018, $321 thousand in 2017 and $130 thousand in 2016. Net charge-offs to average loans were 0.01%, 0.05% and 0.02% in 2018, 2017 and 2016, respectively. The provision for loan losses remained at $500 thousand from 2017 to 2018 and decreased $600 thousand from 2016 to 2017. The allowance for loan losses increased $407 thousand from December 31, 2017 to December 31, 2018.

In evaluating the allowance for loan losses, management considers the composition of the loan portfolio, the historical loan loss experience, the overall quality of the loans and an assessment of current economic conditions.
At December 31, 2018, the allowance for loan losses was 1.18% of loans outstanding compared to 1.19% at year-end 2017 and 1.15% at year-end 2016. Management believes the allowance for loan losses at the year-end 2018 is adequate to cover probable incurred credit losses within the portfolio.

The following tables set forth an allocation for the allowance for loan losses and loans by category. In making the allocation, management evaluates the risk in each category, current economic conditions and charge-off experience. An allocation for the allowance for loan losses is an estimate of the portion of the allowance that represents probable incurred losses in each loan category, but it does not preclude any portion of the allowance allocated to one type of loan being used to absorb losses of another loan type.

Allowance for Loan Losses (in thousands)	2018	2017	2016	2015	2014
Commercial	$ 1,265	$ 1,069	$ 862	$ 536	$ 410
Real Estate Construction	451	507	616	453	400
Real Estate Mortgage:					
1-4 Family Residential	2,843	2,538	2,515	2,296	2,145
Multi-family Residential	800	702	635	505	562
Non-farm & Non-residential	1,799	1,704	1,315	1,338	800
Agricultural	458	542	935	748	1,125
Consumer and other	511	658	663	645	570
Total	$ 8,127	$ 7,720	$ 7,541	$ 6,521	$ 6,012

Loans (in thousands)	2018		2017		2016		2015		2014	
	Dollars	Percentage	Dollars	Percentage	Dollars	Percentage	Dollars	Percentage	Dollars	Percentage
Commercial	$ 86,149	12.56 %	$ 80,070	12.35 %	$ 77,436	11.80 %	$ 55,929	8.96 %	$ 47,185	8.77
Real Estate Construction	24,254	3.54	20,816	3.21	29,169	4.45	29,320	4.70	16,938	3.15
Real Estate Mortgage:										
1-4 Family Residential	252,318	36.77	238,121	36.72	244,638	37.29	230,721	37.0	189,458	35.20
Multi-family Residential	46,403	6.76	39,926	6.16	47,199	7.19	38,281	6.13	34,415	6.39
Non-farm & Non-residential	196,674	28.66	192,074	29.62	176,024	26.83	183,692	29.43	161,822	30.06
Agricultural	60,049	8.75	59,176	9.12	62,491	9.53	66,782	10.70	71,345	13.25
Consumer	20,089	2.93	18,182	2.80	18,867	2.88	18,880	3.03	16,863	3.13
Other	208	0.03	170	0.03	183	0.03	516	0.08	279	0.05
Total, Net (1)	$686,144	100.00 %	$648,535	100.00 %	$656,007	100.00 %	$624,121	100.00 %	$538,305	100.00 %

(1) Net of deferred loan fees

Off-balance Sheet Arrangements

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

Financial instruments with off-balance sheet risk were as follows at year-end (in thousands):

	2018	2017
Unused lines of credit	$ 117,660	$ 98,413
Commitments to make loans	17,200	17,249
Letters of credit	552	672

Unused lines of credit are substantially all at variable rates. Commitments to make loans are generally made for a period of 60 days or less and are primarily fixed at current market rates ranging from 3.88% to 6.50% with maturities ranging up to 30 years.

Capital

As displayed by the following table, the Company's Tier I capital (as defined by the Federal Reserve Board under the Board's risk-based guidelines) at December 31, 2018 increased $9.0 million to $103.1 million from December 31, 2017. Stockholders' equity, excluding accumulated other comprehensive income, was $110.3 million at December 31, 2018 compared to $101.3 million at December 31, 2017. Included in Tier I capital is $7 million of trust preferred securities issued in August 2003. The disallowed amount of stockholders' equity is mainly attributable to the goodwill and/or core deposit intangibles, resulting from the Kentucky First acquisition in 2003, the Peoples Bank acquisition in 2006 and the Madison Financial Corporation acquisition in 2015. The Company's risk-based capital and leverage ratios, as shown in the following table, exceeded the levels required to be considered "well capitalized". The leverage ratio compares Tier I capital to total average assets less disallowed amounts of goodwill.

	For the Year Ended December 31, (in thousands)		
Consolidated	**2018**	**2017**	**Change**
Stockholders' Equity (1)	$ 110,271	$ 101,326	$ 8,945
Trust Preferred Securities	7,000	7,000	—
Less Disallowed Amount	(14,188)	(14,234)	46
Tier I Capital	103,083	94,092	8,991
Allowance for Loan Losses	8,202	7,795	407
Other	—	9	(9)
Tier II Capital	8,202	7,804	398
Total Capital	111,285	101,896	9,389
Total Risk Weighted Assets	$ 718,552	$ 682,481	$ 36,071
Ratios:			
Common Equity Tier I Capital to Risk-weighted Assets	13.4 %	12.8 %	0.6 %
Tier I Capital to Risk-weighted Assets	14.3 %	13.8 %	0.5 %
Total Capital to Risk-weighted Assets	15.5 %	14.9 %	0.6 %
Leverage	9.7 %	9.2 %	0.5 %

	For the Year Ended December 31, (in thousands)		
Bank Only	**2018**	**2017**	**Change**
Stockholders' Equity (1)	$ 111,331	$ 106,118	$ 5,213
Less Disallowed Amount	(14,188)	(14,234)	46
Tier I Capital	97,143	91,884	5,259
Allowance for Loan Losses	8,202	7,795	407
Other	—	9	(9)
Tier II Capital	8,202	7,804	398
Total Capital	105,345	99,688	5,657
Total Risk Weighted Assets	$ 718,698	$ 682,260	$ 36,438
Ratios:			
Common Equity Tier I Capital to Risk-weighted Assets	13.5 %	13.5 %	— %
Tier I Capital to Risk-weighted Assets	13.5 %	13.5 %	0.0 %
Total Capital to Risk-weighted Assets	14.7 %	14.6 %	0.1 %
Leverage	9.2 %	9.0 %	0.2 %

(1) Excluding accumulated other comprehensive income/loss.

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") established five capital categories for insured depository institutions under its Prompt Corrective Action Provisions. The bank regulatory agencies adopted regulations, which became effective in 1992, defining these five capital categories for banks they regulate. The categories vary from "well capitalized" to "critically undercapitalized".

A "well capitalized" bank is defined as one with a total risk-based capital ratio of 10% or more, a Tier I risk-based capital ratio of 8% or more, a leverage ratio of 5% or more, and one not subject to any order, written agreement, capital directive, or prompt corrective action directive to meet or maintain a specific capital level. At December 31, 2018, the bank had ratios that exceeded the minimum requirements established for the "well capitalized" category.

In July 2013, the FDIC and the other federal bank regulatory agencies issued a final rule that will revise their leverage and risk-based capital requirements and the method of calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. Among other things, the rule establishes a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets), increases the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets) and assigns a higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property.

The final rule also requires unrealized gains and losses on certain "available-for-sale" securities holdings to be included for purposes of calculating regulatory capital requirement unless a one-time opt-in or opt-out is exercised. The rule limits a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The final rule became effective for the Bank on January 1, 2015. The capital conservation buffer requirement was phased in beginning January 1, 2016 and will end January 1, 2019, when the full capital conservation buffer requirement will be effective.

In management's opinion, there are no other known trends, events or uncertainties that will have or that are reasonably likely to have a material effect on the Company's liquidity, capital resources or operations.

Securities and Federal Funds Sold

Securities, classified as available for sale, decreased from $318.2 million at December 31, 2017 to $315.4 million at December 31, 2018. Federal funds sold totaled $266 thousand at December 31, 2018 and $321 thousand at December 31, 2017.

Per Company policy, fixed rate asset backed securities will not have an average life exceeding seven years, but final maturity may be longer. Adjustable rate securities shall adjust within three years per Company policy. As of both December 31, 2018 and 2017, the Company held $11 million in adjustable-rate mortgage backed securities. Unrealized gains (losses) on investment securities are temporary and change inversely with movements in interest rates. In addition, some prepayment risk exists on mortgage-backed securities and prepayments are likely to increase with decreases in interest rates. The following tables present the investment securities for each of the past three years and the maturity and yield characteristics of securities as of December 31, 2018.

Securities Available for Sale and Trading Assets at Fair Value

	For the Year ended December 31, (in thousands)		
Investment Securities (at fair value)	**2018**	**2017**	**2016**
Available for Sale			
U.S. treasury notes	$ 3,975	$ 4,024	$ —
U.S. government agencies	41,178	41,705	36,528
States and political subdivisions	64,204	83,382	91,132
Mortgage-backed			
GNMA, FNMA, FHLMC Passthroughs	39,078	44,226	51,557
GNMA, FNMA, FHLMC CMO's	156,734	137,747	94,213
Total mortgage backed	195,812	181,973	145,770
Asset-backed	10,200	6,753	—
Equity Securities	—	340	340
Total	$ 315,369	$ 318,177	$ 273,770
Trading Assets	$ —	$ —	$ 5,592

Maturity Distribution of Securities Available for Sale

	December 31, 2018 (in thousands)					
	One Year or Less	Over One Year Through Five Years	Over Five Years Through Fifteen Years	Over Fifteen Years	Asset Backed	Total
Available for Sale						
U.S. treasury note	$ —	$ 3,975	$ —	$ —	$ —	$ 3,975
U.S. government agencies	—	32,394	5,608	3,176	—	41,178
States and political subdivisions	—	11,837	38,253	14,114	—	64,204
Mortgage-backed	—	—	—	—	195,812	195,812
Asset-backed	—	—	—	—	10,200	10,200
Total	—	48,206	43,861	17,290	206,012	315,369
Percent of Total	— %	15.3 %	13.9 %	5.5 %	65.3 %	100 %
Weighted Average Yield (1)	— %	2.46 %	3.82 %	4.15 %	2.99 %	3.09 %

(1) Tax Equivalent yield

Impact of Inflation and Changing Prices

The majority of the Company's assets and liabilities are monetary in nature. Therefore, the Company differs greatly from most commercial and industrial companies that have significant investments in nonmonetary assets and inventories. However, inflation does have an important impact on the growth of assets in the banking industry and the resulting need to increase equity capital at higher than normal rates in order to maintain an appropriate equity to assets ratio. Inflation also affects other expenses, which tend to rise during periods of inflation.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the risk of loss arising from adverse changes in market prices and rates. Management considers interest rate risk and liquidity risk to be significant market risks to the Company, but considers interest risk to be the most significant.

Kentucky Bank's Asset/Liability Committee oversees the Company's interest rate risk and liquidity risks. The Bank has developed procedures designed to ensure safety and soundness, maintain liquidity and regulatory capital standards, and achieve acceptable net interest income. The exposure to market risk is reviewed on a regular basis by the Asset/Liability Committee.

Interest Rate Risk. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximize income.

Management realizes certain risks are inherent and that the goal is to identify and minimize the risks. The primary tool used by management is an interest rate shock simulation model.

Certain assumptions, such as prepayment risks, are included in the model. However, actual prepayments may differ from those assumptions. In addition, immediate withdrawal of interest checking and other savings accounts may have an effect on the results of the model.

The following table depicts the change in net interest income resulting from 100 and 300 basis point changes in rates. The projections are based on balance sheet growth assumptions and repricing opportunities for new, maturing and adjustable rate amounts. In addition, the projected percentage changes from level rates are outlined below along with the Board of Directors approved limits. As of December 31, 2018 the projected net interest income percentages are within the Board of Directors limits. Please note that in the current low interest rate environment, many rates cannot decline 100 basis points.

Therefore, the projected net interest income changes below as of December 31, 2018 and 2017 for a declining rate environment are not as relevant. The projected net interest income report summarizing the Company's interest rate sensitivity as of December 31, 2018 and 2017 is as follows:

Projected Net Interest Income (December 31, 2018)

Rate Change:	**—100**	**Level Rates**	**100**	**300**
Year One (1/19 - 12/19)				
Net interest income percentage change	(5.8)%	N/A	(1.3) %	(5.5) %
Board approved limit	>- 6.0 %	N/A	>- 6.0 %	>- 13.0 %

Projected Net Interest Income (December 31, 2017)

Rate Change:	**—100**	**Level Rates**	**100**	**300**
Year One (1/18 - 12/18)				
Net interest income percentage change	(2.4)%	N/A	0.3 %	0.4 %
Board approved limit	>- 6.0 %	N/A	>- 4.0 %	>- 10.0 %

The numbers in 2018 are comparable to 2017. In 2018, year one reflected a 1.3% decrease in projected net interest income compared to a 0.3% projected increase in 2017 with a 100 basis point increase. The 300 basis point increase in rates reflected a 5.5% decrease in net interest income in 2018 and a 0.4% increase in 2017. The 100 point decrease in rates reflected a 5.8% decrease in net interest income in 2018 compared to a 2.4% decrease in 2017.

Management measures the Company's interest rate risk by computing estimated changes in net interest income in the event of a range of assumed changes in market interest rates. The Company's exposure to interest rates is reviewed on a monthly basis by senior management and quarterly with the Board of Directors.

Exposure to interest rate risk is measured with the use of interest rate sensitivity analysis to determine the change in net interest income in the event of hypothetical changes in interest rates, while interest rate sensitivity gap analysis is used to determine the repricing characteristics of the Company's assets and liabilities. If estimated changes to net interest income are not within the limits established by the Board, the Board may direct management to adjust the Company's asset and liability mix to bring interest rate risk within Board approved limits.

Liquidity Risk. Liquidity risk is the possibility that the Company may not be able to meet its cash requirements. Management of liquidity risk includes maintenance of adequate cash and sources of cash to fund operations and meet the needs of borrowers, depositors and creditors. Excess liquidity generally has a negative impact on earnings resulting from the lower yields on short-term assets.

In addition to cash and cash equivalents, the securities portfolio provides an important source of liquidity. Total securities maturing within one year along with cash and cash equivalents totaled $26.1 million at December 31, 2018. Additionally, securities available-for-sale with maturities greater than one year and mortgage-backed and equity securities totaled $315.4 million at December 31, 2018. The available for sale securities are available to meet liquidity needs on a continuing basis.

The Company maintains a relatively stable base of customer deposits and its steady growth is expected to be adequate to meet its funding demands. In addition, management believes the majority of its $100,000 or more certificates of deposit are no more volatile than its core deposits. At December 31, 2018 these balances totaled $109.8 million, approximately 13% of total deposits.

The Company also relies on Federal Home Loan Bank advances for both liquidity and asset/liability management purposes. These advances are used primarily to fund long-term fixed rate residential mortgage loans. We have sufficient collateral to borrow an additional $75 million from the Federal Home Loan Bank at December 31, 2018. In addition, as of December 31, 2018, $38 million is available in overnight borrowing through various correspondent banks and the Company has access to an additional $302 million in brokered deposits.

Generally, the Company relies upon net cash inflows from financing activities, supplemented by net cash inflows from operating activities, to provide cash used in its investing activities. As is typical of many financial institutions, significant financing activities include deposit gathering, and the use of short-term borrowings, such as federal funds purchased and securities sold under repurchase agreements along with long-term debt. The Company's primary investing activities include purchasing investment securities and loan originations. Management believes there is sufficient cash flow from operations to meet investing and liquidity needs related to reasonable borrower, depositor and creditor needs in the present economic environment.

The cash flow statements for the periods presented provide an indication of the Company's sources and uses of cash as well as an indication of the ability of the Company to maintain an adequate level of liquidity.

A number of other techniques are used to measure the liquidity position, including the ratios presented below. These ratios are calculated based on annual averages for each year.

	December 31,		
Liquidity Ratios	**2018**	**2017**	**2016**
Average Loans (including loans held for sale)/Average Deposits	81.2 %	81.5 %	84.2 %
Average Securities sold under agreements to repurchase and other borrowings/Average Assets	2.2 %	3.3 %	3.6 %

Item 8. Financial Statements

The management of the Company has the responsibility for preparing the accompanying consolidated financial statements and for their integrity and objectivity. The statements were prepared in accordance with generally accepted accounting principles in the United States of America. The consolidated financial statements include amounts that are based on management's best estimates and judgments. Management also prepared other information in the annual report and is responsible for its accuracy and consistency with the financial statements.

The Company's 2018 consolidated financial statements have been audited by Crowe LLP, an independent registered public accounting firm.

Stockholders and the Board of Directors of Kentucky
Bancshares, Inc.
Paris, Kentucky

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Kentucky Bancshares, Inc. (the "Company") as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three- year period ended December 31, 2018, and the related notes (collectively referred to as the "financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on the criteria established in Internal Control – Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2018 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on the criteria established in Internal Control – Integrated Framework: (2013) issued by COSO.

Basis for Opinions

The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control. Our responsibility is to express an opinion on the Company's financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

/s/Crowe LLP

Crowe LLP

We have served as the Company's auditor since 1998.

Washington D.C.
March 15, 2019

KENTUCKY BANCSHARES, INC.
Paris, Kentucky

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018, 2017 and 2016

CONSOLIDATED BALANCE SHEETS
As of December 31,
(Dollar amounts in thousands except per share data)

	2018	2017
ASSETS		
Cash and due from banks	$ 25,835	$ 38,851
Federal funds sold	266	321
Cash and cash equivalents	26,101	39,172
Interest bearing time deposits	2,175	1,830
Securities available for sale	315,369	318,177
Loans held for sale	1,203	1,231
Loans	686,144	648,535
Allowance for loan losses	(8,127)	(7,720)
Net loans	678,017	640,815
Federal Home Loan Bank stock	7,034	7,034
Real estate owned, net	830	2,404
Bank premises and equipment, net	17,349	16,539
Interest receivable	4,150	3,951
Mortgage servicing rights	1,536	1,511
Goodwill	14,001	14,001
Other intangible assets	238	369
Bank owned life insurance	10,198	—
Other assets	7,811	6,159
Total assets	$ 1,086,012	$ 1,053,193
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Non-interest bearing	$ 231,429	$ 230,241
Time deposits, $250,000 and over	59,736	79,578
Other interest bearing	559,277	505,454
Total deposits	850,442	815,273
Repurchase agreements	8,077	19,900
Short-term Federal Home Loan Bank advances	11,600	8,400
Long-term Federal Home Loan Bank advances	88,852	90,332
Note payable	2,718	3,321
Subordinated debentures	7,217	7,217
Interest payable	893	838
Other liabilities	9,420	7,583
Total liabilities	979,219	952,864
Stockholders' equity		
Preferred stock, 300,000 shares authorized and unissued	—	—
Common stock, no par value (1); 10,000,000 shares authorized; 5,955,242 and 5,943,044 shares issued and outstanding at December 31, 2018 and December 31, 2017	21,170	20,931
Retained earnings	89,101	80,395
Accumulated other comprehensive loss	(3,478)	(997)
Total stockholders' equity	106,793	100,329
Total liabilities and stockholders' equity	$ 1,086,012	$ 1,053,193

(1) See Note 1 in the notes to the consolidated financial statements for more detail on the stock split.

See accompanying notes.

CONSOLIDATED STATEMENTS OF INCOME
Years Ended December 31,
(Dollar amounts in thousands except per share data)

	2018	2017	2016
Interest income			
Loans, including fees	$ 34,063	$ 30,918	$ 30,000
Securities			
Taxable	6,023	4,618	3,362
Tax exempt	1,829	2,411	2,618
Trading Assets	—	108	153
Other	717	604	421
	42,632	38,659	36,554
Interest expense			
Deposits	4,241	2,694	2,211
Repurchase agreements and other borrowings	133	123	108
Federal Home Loan Bank advances	1,910	1,697	1,620
Note payable	153	190	233
Subordinated debentures	365	310	254
	6,802	5,014	4,426
Net interest income	35,830	33,645	32,128
Provision for loan losses	500	500	1,150
Net interest income after provision for loan losses	35,330	33,145	30,978
Other income			
Service charges	5,266	5,113	5,086
Loan service fee income, net	233	315	71
Trust department income	1,348	1,183	1,086
Securities gains (losses), net	(65)	52	287
Gain (loss) on trading assets, net	—	6	(92)
Gain on sale of loans	1,560	1,727	2,098
Brokerage income	665	818	778
Debit card interchange income	3,273	3,045	2,740
Gain (loss) on sale of bank premises and equipment	(9)	1,200	—
Income from bank-owned life insurance	262	—	—
Other	430	349	95
	12,963	13,808	12,149
Other expenses			
Salaries and employee benefits	18,938	18,002	17,930
Occupancy expense	3,944	3,773	3,772
Repossession expense, net	98	208	401
FDIC insurance	307	349	526
Legal and professional fees	908	1,082	1,628
Data processing	1,953	1,714	1,627
Debit card expenses	1,767	1,667	1,311
Amortization	130	160	247
Advertising and marketing	859	726	925
Taxes other than payroll, property and income	1,215	1,188	1,134
Telephone	370	387	345
Postage	310	359	357
Loan fees	158	189	198
Other	3,252	3,269	3,384
	34,209	33,073	33,785
Income before income taxes	14,084	13,880	9,342
Provision for income taxes	1,654	3,163	773
Net income	$ 12,430	$ 10,717	$ 8,569
Earnings per share (1):			
Basic	$ 2.09	$ 1.81	$ 1.43
Diluted	2.09	1.81	1.43

(1) See Note 1 in the notes to the consolidated financial statements for more detail on the stock split.

See accompanying notes.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years Ended December 31,
(Dollar amounts in thousands except per share data)

	2018	2017	2016
Net income	$ 12,430	$ 10,717	$ 8,569
Other comprehensive income (loss)			
Unrealized gains (losses) on securities arising during the period	(3,205)	199	(1,706)
Reclassification of realized amount	65	(52)	(287)
Net change in unrealized gain (loss) on securities	(3,140)	147	(1,993)
Less: Tax impact	659	(24)	678
Other comprehensive income (loss)	(2,481)	123	(1,315)
Comprehensive income	$ 9,949	$ 10,840	$ 7,254

See accompanying notes.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years Ended December 31, 2018, 2017 and 2016
(Dollar amounts in thousands except per share data)

	Common Stock		Retained	Accumulated Other Comprehensive	Total Stockholders'
	Shares (1)	Amount	Earnings	Loss	Equity
Balances, January 1, 2016	5,978,410	$20,730	$ 68,324	$ 359	$ 89,413
Common stock issued (employee stock grants of 12,340 shares and director stock awards of 2,704 shares, net of 2,362 shares forfeited)	12,682	49	—	—	49
Stock compensation expense	—	153	—	—	153
Common stock purchased and retired	(44,628)	(165)	(503)	—	(668)
Other comprehensive income	—	—	—	(1,315)	(1,315)
Net income	—	—	8,569	—	8,569
Dividends declared - $0.54 per share	—	—	(3,229)	—	(3,229)
Balances, December 31, 2016	5,946,464	$20,767	$ 73,161	$ (956)	$ 92,972
Common stock issued (employee stock grants of 10,668 shares, net of 2,482 shares forfeited, director stock grants of 2,772 shares and director stock options exercised of 1,200 shares)	14,640	64	—	—	64
Stock compensation expense	—	163	—	—	163
Common stock purchased and retired	(18,060)	(63)	(200)	—	(263)
Reclassification of disproportionate tax effects			164	(164)	—
Other comprehensive income	—	—	—	123	123
Net income	—	—	10,717	—	10,717
Dividends declared - $0.58 per share	—	—	(3,447)	—	(3,447)
Balances, December 31, 2017	5,943,044	$20,931	$ 80,395	$ (997)	$ 100,329
Common stock issued (employee stock grants of 9,036 shares, net of 2,404 shares forfeited, director stock grants of 1,962 shares and director stock options exercised of 1,200 shares)	12,198	64	—	—	64
Stock compensation expense	—	175	—	—	175
Other comprehensive loss	—	—	—	(2,481)	(2,481)
Net income	—	—	12,430	—	12,430
Dividends declared - $0.625 per share	—	—	(3,724)	—	(3,724)
Balances, December 31, 2018	5,955,242	$21,170	$ 89,101	$ (3,478)	$ 106,793

(1) See Note 1 in the notes to the consolidated financial statements for more detail on the stock split.

See accompanying notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31,
(Dollar amounts in thousands except per share data)

	2018	2017	2016
Cash flows from operating activities			
Net income	$ 12,430	$ 10,717	$ 8,569
Adjustments to reconcile net income to net cash from operating activities:			
Depreciation and amortization	1,244	1,205	1,309
Amortization (accretion), net	(343)	(476)	(194)
Provision for loan losses	500	500	1,150
Securities amortization, net	850	1,041	1,133
Securities (gains) losses, net	65	(52)	(287)
Net change in trading assets, excluding proceeds from liquidation	—	(114)	(61)
Proceeds from liquidation of trading assets	—	5,706	—
Net increase in cash surrender value of bank-owned life insurance	(198)	—	—
Originations of loans held for sale	(62,616)	(56,502)	(62,275)
Proceeds from sale of loans	64,204	57,722	64,273
Gain on sale of loans	(1,560)	(1,727)	(2,098)
Stock based compensation expense	175	163	153
Losses (gain) on disposal of fixed assets	9	(1,200)	—
Losses (gain) on other real estate	(173)	(33)	(128)
Write-downs of other real estate, net	—	20	187
Deferred taxes	165	415	(309)
Changes in:			
Interest receivable	(199)	(236)	(34)
Other assets	(894)	806	1,624
Interest payable	55	146	33
Other liabilities	1,837	461	(151)
Net cash from operating activities	$ 15,551	$ 18,562	$ 12,894
Cash flows from investing activities			
Net change in interest bearing time deposits	(345)	3,199	(155)
Purchases of securities, available for sale	(73,504)	(123,615)	(145,232)
Proceeds from sales of securities, available for sale	26,649	27,121	23,888
Purchase of bank-owned life insurance	(10,000)	—	—
Proceeds from principal payments and maturities of securities	45,344	51,283	108,949
Net change in loans	(37,454)	5,700	(35,357)
Purchases of bank premises and equipment	(2,063)	(2,896)	(462)
Capitalized expenditures for other real estate	(74)	(47)	—
Proceeds from sale of other real estate	2,022	1,377	4,199
Proceeds from sale of bank premises and equipment	—	2,102	4
Net cash from investing activities	$ (49,425)	$ (35,776)	$ (44,166)
Cash flows from financing activities			
Net change in deposits	35,169	12,292	44,000
Net change in repurchase agreements and other borrowings	(11,823)	(973)	2,359
Net change in short-term advances from Federal Home Loan Bank	3,200	8,400	—
Long-term FHLB advances	16,394	13,000	15,000
Payments on long-term FHLB advances	(17,874)	(15,168)	(10,333)
Payments on note payable	(603)	(769)	(704)
Proceeds from issuance of common stock, including options and grants, including tax benefits	64	64	49
Purchase of common stock	—	(263)	(668)
Dividends paid	(3,724)	(3,447)	(3,229)
Net cash from financing activities	$ 20,803	$ 13,136	$ 46,474

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31,
(Dollar amounts in thousands except per share data)

	2018	2017	2016
Net change in cash and cash equivalents	$ (13,071)	$ (4,078)	$ 15,202
Cash and cash equivalents at beginning of year	39,172	43,250	28,048
Cash and cash equivalents at end of year	$ 26,101	$ 39,172	$ 43,250
Supplemental disclosures of cash flow information Cash paid during the year for:			
Interest expense	$ 6,747	$ 4,868	$ 4,393
Income taxes	2,085	2,400	800
Supplemental schedules of non-cash investing activities			
Real estate acquired through foreclosure	$ 201	$ 1,897	$ 3,735
Equity securities reclassified to other assets	264	—	—
Transfer of premises and equipment to held for sale	—	—	969

See accompanying notes.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation: The consolidated financial statements include the accounts of Kentucky Bancshares, Inc. (the Company), its wholly-owned subsidiaries, Kentucky Bank (the Bank) and KBI Insurance Company, Inc., a captive insurance subsidiary, and the Bank's wholly-owned subsidiary, KB Special Assets Unit, LLC. Intercompany transactions and balances have been eliminated in consolidation.

Nature of Operations: The Bank operates under a state bank charter and provides full banking services, including trust services, to customers located in Bourbon, Clark, Elliot, Fayette, Harrison, Jessamine, Madison, Rowan, Scott, Woodford and adjoining counties in Kentucky. As a state bank, the Bank is subject to regulation by the Kentucky Department of Financial Institutions and the Federal Deposit Insurance Corporation (FDIC). The Company, a bank holding company, is regulated by the Federal Reserve. KBI Insurance Company, Inc., a captive insurance subsidiary, is regulated by the State of Nevada Division of Insurance.

Subsequent Events: The Company has evaluated subsequent events for recognition and disclosure through March 15, 2019 which is the date the financial statements were available to be issued.

Estimates in the Financial Statements: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash Flows: For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold, and certain short-term investments with maturities of less than three months. Generally, federal funds are sold for one-day periods. Net cash flows are reported for loan, deposit and short-term borrowing transactions.

Interest Bearing Time Deposits: Interest bearing time deposits in other financial institutions have original maturities between one and three years and are carried at cost.

Securities: The Company is required to classify its securities portfolio into one of three categories: trading securities, securities available for sale and securities held to maturity. Fair value adjustments are made to the securities based on their classification with the exception of the held to maturity category. The Company has no investments classified as trading securities or held to maturity. Securities available for sale are carried at fair value. Unrealized holding gains and losses for securities which are classified as available for sale are reported in other comprehensive income, net of deferred tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the settlement date and determined using the specific identification method.

On January 1st, 2018, the Company adopted the new accounting standard for Financial Instruments, which requires equity investments to be measured at fair value with changes in fair value recognized in net income. Equity investments are included in other assets with changes in fair value recorded in other income.

Management evaluates securities for other-than-temporary impairment ("OTTI") at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings.

For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

<u>Loans Held for Sale</u>: Loans held for sale are carried at the lower of cost or fair value as determined by outstanding commitments from investors or current secondary market prices, calculated on the aggregate loan basis. The Company also provides for any losses on uncovered commitments to lend or sell. The Company sells loans with servicing rights retained and also with servicing rights released.

<u>Loans:</u> Loans that management has the intent and ability to hold for the foreseeable future or until maturity are stated at the amount of unpaid principal, net of deferred loan origination fees and costs and acquired purchase premiums and discounts, reduced by an allowance for loan losses. Interest income on loans is recognized on the accrual basis except for those loans on a nonaccrual status. Interest income on real estate mortgage (1-4 family residential and multi-family residential) and consumer loans is discontinued at the time the loan is 90 days delinquent, and interest income on real estate construction, non-farm and non-residential mortgage, agricultural and commercial loans is discontinued at the time the loan is 120 days delinquent, unless the loan is well-secured and in process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield on the related loan. Recorded investment is the outstanding loan balance, excluding accrued interest receivable.

When interest accrual is discontinued, interest income received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Typically, the Company seeks to establish a payment history of at least six consecutive payments made on a timely basis before returning a loan to accrual status. Consumer and credit card loans are typically charged off no later than 120 days past due. Loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

<u>Concentration of Credit Risk:</u> Most of the Company's business activity is with customers located within Bourbon, Clark, Elliott, Fayette, Harrison, Jessamine, Madison, Rowan, Scott, Woodford and surrounding counties located in Kentucky. Therefore, the Company's exposure to credit risk is significantly affected by changes in the economy in these counties.

<u>Allowance for Loan Losses</u>: The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

Adjustments are made to the historical loss experience ratios based on the qualitative factors as outlined in the regulatory Interagency Policy Statement on the Allowance for Loan and Lease Losses. These qualitative factors include the nature and volume of portfolio, economic and business conditions, classification, past due and non-accrual trends. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

The allowance for loan losses is evaluated at the portfolio segment level using the same methodology for each segment. The recent historical actual net losses is the basis for the general reserve for each segment which is then adjusted for qualitative factors as outlined above (i.e., nature and volume of portfolio, economic and business conditions, classification, past due and non-accrual trends) specifically evaluated at individual segment levels.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. The general component covers non-classified loans and is based on historical loss experience adjusted for current factors for non-classified loans and a migration analysis for classified loans.

A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans, for which the terms have been modified, and for which the borrower is experiencing financial difficulties and has been granted a concession, are considered troubled debt restructurings and classified as impaired.

Loans are charged off when available information confirms that loans, or portions thereof, are uncollectible. While management considers the number of days a loan is past due in its evaluation process, we also consider a variety of other factors.

Factors considered by management in evaluating the charge-off decision include collateral value, availability of current financial information for both borrower and guarantor, and the probability of collecting contractual principal and interest payments. These considerations may result in loans being charged off before they are 90 days or more past due. This evaluation framework for determining charge-offs is consistently applied to each segment.

From time to time, the Company will charge-off a portion of impaired and non-performing loans. Loans that meet the criteria under ASC 310 are evaluated individually for impairment. Management considers payment status, collateral value, availability of current financial information for the borrower and guarantor, actual and expected cash flows, and probability of collecting amounts due. If a loan's collection status is deemed to be collateral dependent or foreclosure is imminent, the loan is charged down to the fair value of the collateral, less selling costs. In circumstances where the loan is not deemed to be collateral dependent, but we believe, after completing our evaluation process, that probable loss has been incurred, we will provide a specific allocation on that loan.

The impact of recording partial charge-offs is a reduction of gross loans and a reduction of the loan loss reserve. The net loan balance is unchanged in instances where the loan had a specific allocation as a component of the allowance for loan losses. The allowance as a percentage of total loans may be lower as the allowance no longer needs to include a component for the loss, which has now been recorded, and net charge-off amounts are increased as partial charge-offs are recorded.

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

Commercial and real estate construction and real estate mortgage loans (multi-family residential, and non-farm and non-residential mortgage) over $200 thousand are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and 1-4 family residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures. Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component covers non-impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company over the most recent 5 years. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations.

A "portfolio segment" is defined as the level at which an entity develops and documents a systematic methodology to determine its allowance for loan losses. The Company has identified the following portfolio segments: commercial, real estate construction, real estate mortgage, agricultural, consumer (credit cards and other consumer) and other (overdrafts).

Commercial: These loans to businesses do not have real estate as the underlying collateral. Instead of real estate, collateral could be business assets such as equipment or accounts receivable or the personal guarantee of one or more guarantors. These loans generally present a higher level of risk than loans secured by commercial real estate because in the event of default by the borrower, the business assets must be liquidated and/or guarantors pursued for deficit funds. Business assets are worth more while they are in use to produce income for the business and worth significantly less if the business is no longer in operation.

Real estate construction: Real estate construction consists of loans secured by real estate for additions or alterations to existing structures, as well as constructing new structures. They include fixed and floating rate loans. Real estate construction loans generally present a higher level of risk than loans secured by 1-4 family residential real estate primarily because of the length of the construction period, potential change in prices of construction, the incomplete status of the collateral and economic cycles. Because of these factors, real estate construction loans generally have higher qualitative adjustments.

Real Estate Mortgage:

1-4 family residential: Loans secured by 1-4 family residential real estate represent the lowest risk of loans for the Company. They include fixed and floating rate loans as well as loans for commercial purposes or consumer purposes. The Company generally does not hold subprime residential mortgages. Borrowers with loans in this category, whether for commercial or consumer purposes, tend to make their payments timely as they do not want to risk foreclosure and loss of property.

Multifamily residential: Loans secured by multifamily residential real estate consist primarily of loans secured by apartment buildings and can be either fixed or floating rate loans. Multi-family residential real estate loans generally present a higher level of risk than loans secured by 1-4 family residential real estate because the borrower's repayment ability typically comes from rents from tenants. Local economic and employment fluctuations impact rent rolls and potentially the borrower's repayment ability.

Non-farm & non-residential: Loans secured by non-farm non-residential real estate consist of loans secured by commercial real estate that is not owner occupied. These loans generally consist of loans collateralized by property whereby rents received from commercial tenants of the borrower are the source of repayment. These loans generally present a higher level of risk than loans secured by owner occupied commercial real estate because repayment risk is expanded to be dependent on the success of multiple businesses which are paying rent to the borrower. If multiple businesses fail due to deteriorating economic conditions or poor business management skills, the borrower may not have enough rents to cover their monthly payment. Repayment risk is also increased depending on the level of surplus available commercial lease space in the local market area.

Agricultural: These loans to agricultural businesses do not have real estate as the underlying collateral. Instead of real estate, collateral could be assets such as equipment or accounts receivable or the personal guarantee of one or more guarantors. These loans generally present a higher level of risk than loans secured by real estate because in the event of default by the borrower, the assets must be liquidated and/or guarantors pursued for deficit funds. Farm assets are worth more while they are in use to produce income and worth significantly less if the farm is no longer in operation.

Consumer: Consumer loans are generally loans to borrowers for non-business purposes. They can be either secured or unsecured. Consumer loans are generally small in the individual amount of principal outstanding and are repaid from the borrower's private funds earned from employment. Consumer lending risk is very susceptible to local economic trends.

If there is a consumer loan default, any collateral that may be repossessed is generally not well maintained and has a diminished value. For this reason, consumer loans tend to have higher overall interest rates to cover the higher cost of repossession and charge-offs. However, due to their smaller average balance per borrower, consumer loans are collectively evaluated for impairment in determining the appropriate allowance for loan losses.

Other: All other loan types are aggregated together for credit risk evaluation due to the varying nature but small number of the remaining types of loans in the Company's loan portfolio. Loans in this segment include but are not limited to overdrafts. Due to their smaller balance, other loans are collectively evaluated for impairment in determining the appropriate allowance for loan losses.

Due to the overall high level of real estate mortgage loans within the loan portfolio as a whole, as compared to other portfolio segments, for risk assessment and allowance purposes this segment was segregated into more granular pools by collateral property type.

The non-farm non-residential and the multi-family real estate mortgage loan portfolio segments had the next highest level of qualitative adjustments due to the effects of local markets and economies on the underlying collateral property values, as well as for industry concentrations and risks related to the this type of property. Within the commercial portfolio, risk analysis is performed primarily based on the individual loan type.

Mortgage Servicing Rights: The Bank has sold certain residential mortgage loans to the Federal Home Loan Mortgage Corporation (FHLMC) while retaining the servicing rights.

Servicing rights are recognized separately when they are acquired through sales of loans. When mortgage loans are sold, servicing rights are initially recorded at fair value with the income statement effect recorded in gain on sale of mortgage loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into loan service fee income, net, included in non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual grouping, to the extent that fair value is less than the carrying amount. If the Company later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase to income. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Servicing fee income, which is reported on the income statement as loan service income, net, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal or a fixed amount per loan and are recorded as income when earned. The amortization of mortgage servicing rights and valuation allowance are netted against loan servicing fee income. Servicing fees totaled $543 thousand, $560 thousand, and $510 thousand for the years ended December 31, 2018, 2017 and 2016 and are included in loan service fee income in the income statement. Late fees and ancillary fees related to loan servicing are not material.

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

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

Bank Premises and Equipment: Land is carried at cost. Bank premises and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight-line method with useful lives ranging from 5 to 40 years. Furniture, fixtures and equipment are depreciated using the straight-line (or accelerated) method with useful lives ranging from 3 to 10 years.

Real Estate Owned: Real estate acquired through foreclosure is initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at the lower of cost or fair value less estimated costs to sell. The value of the underlying loan is written down to the fair value of the real estate to be acquired by a charge to the allowance for loan losses, if necessary. Any subsequent write-downs are charged to operating expenses. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in other expenses.

Investments in Limited Partnerships: Investments in limited partnerships represent the Company's investments in affordable housing projects for the primary purpose of available tax benefits. The Company is a limited partner in these investments and as such, the Company is not involved in the management or operation of such investments. These investments are amortized over the period that the Company expects to receive the tax benefits. These investments are evaluated for impairment when events indicate the carrying amount may not be recoverable. The investment recorded at December 31, 2018 was $4.2 million and $3.8 million at December 31, 2017, respectively, and is included with other assets in the balance sheet. During the years ended December 31, 2018 and 2017, the Company recognized amortization expense of $624 thousand and $799 thousand, respectively, which was included within other noninterest expense on the consolidated statements of income.

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

Stock-Based Compensation: Compensation cost is recognized for stock options and restricted stock awards issued to employees, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

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

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

The Company recognizes interest related to income tax matters as interest expense and penalties related to income tax matters as other expense.

Retirement Plans: Employee 401(k) and profit sharing plan expense is the amount of matching contributions.

Goodwill and Intangible Assets: Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually. The Company has selected December 31 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on our balance sheet.

Intangible assets consist of core deposit intangible assets arising from whole bank and branch acquisitions. They are initially measured at fair value and then are amortized on either an accelerated or straight-line basis, over ten or fifteen years.

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

Earnings Per Common Share: Basic earnings per common share is net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share include the dilutive effect of additional potential common shares issuable under stock options. Earnings and dividends per share have been adjusted in all periods presented to give effect to all stock splits and dividends through the date of issuance of the financial statements.

Stock Split: On November 21, 2018, the Company announced that its Board of Directors declared a two-for-one stock split (the "Stock Split") of the Company's issued and outstanding common stock ("Common Stock"), no par value per share, pursuant to which one (1) additional share of the Common Stock was issued for each share of Common Stock held by shareholders of record as of the close of business on December 3, 2018. The additional shares were issued on December 10, 2018. Earnings and dividends per share, and the number of shares are restated for the Stock Split through the date of issuance of the financial statements.

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

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Operating Segments: While the Company's chief decision makers monitor the revenue streams of the various Company products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Accordingly, all of the Company's operations are considered by management to be aggregated into one reportable operating segment: banking.

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

Adoption of New Accounting Standards

ASU 2016-13, "Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." Issued in June 2016, ASU 2016-13 will add Financial Accounting Standards Board "FASB" ASC Topic 326, "Financial Instruments-Credit Losses" and finalizes amendments to FASB ASC Subtopic 825-15, "Financial Instruments-Credit Losses." The amendments of ASU 2016-13 are intended to provide financial statement users with more decision-useful information related to expected credit losses on financial instruments and other commitments to extend credit by replacing the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to determine credit loss estimates.

The amendment requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to enhance their credit loss estimates. The amendment requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this update become effective for annual periods and interim periods within those annual periods beginning after December 15, 2019. Early adoption will be permitted beginning after December 15, 2018.

As previously disclosed, the Company formed a steering committee to oversee the adoption of the ASU at the effective date. Appropriate members of Senior Management have developed a plan focused on understanding the ASU, researching issues, identifying data needs for modeling inputs, technology requirements, and modeling considerations. During 2019, the Company is focused on the completion of its model, refining assumptions, and continued review of the model.

Concurrent with this, the Company is also focused on researching and resolving interpretive accounting issues in the ASU, contemplating various related accounting policies, developing processes and related controls, and considering various reporting disclosures.

As of the beginning of the first reporting period in which the new standard is effective, the Company expects to recognize a one-time cumulative effect adjustment increasing the allowance for loan losses, if any, since the ASU covers credit losses over the expected life of a loan as well as considering future changes in macroeconomic conditions. The magnitude of any such one-time adjustment or the overall impact of the new guidance on the consolidated financial statements cannot yet be reasonably estimated , however, we expect to identify a
range in our Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2019.

In December 2018, the OCC, the Board of Governors of the Federal Reserve System, and the FDIC approved a final rule to address changes to credit loss accounting under GAAP, including banking organizations' implementation of CECL. The final rule provides banking organizations the option to phase in over a three-year period the day-one adverse effects on regulatory capital that may result from the adoption of the new accounting standard.

ASU 2016-02, "Leases (Topic 842)." In February 2016, the FASB issued its new lease accounting guidance in ASU No. 2016-02, *Leases (Topic 842)*. Under the new guidance, lessees will be required to recognize the following for all leases, with the exception of short-term leases, at the commencement date: (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged.

In July 2018, the FASB issued ASU No. 2018-10, *Codification Improvements to Topic 842, Leases* and ASU No. 2018-11, *Leases (Topic 842): Targeted Improvements*. ASU No. 2018-10 provides improvements related to ASU No. 2016-02 to increase stakeholders' awareness of the amendments and to expedite the improvements. The amendments affect narrow aspects of the guidance issued in ASU No. 2016-02. ASU No. 2018-11 allows entities adopting ASU No. 2016-02 to choose an additional (and optional) transition method, under which an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. ASU No. 2018-11 also allows lessors to not separate non-lease components from the associated lease component if certain conditions are met. The amendments in these updates become effective for annual periods and interim periods within those annual periods beginning after December 15, 2018.

Kentucky Bancshares elected the optional transition method permitted by ASU No. 2018-11. Under this method, an entity shall recognize and measure leases that exist at the application date and prior comparative periods are not adjusted. In addition, Kentucky Bancshares elected the package of practical expedients to leases that commenced before the effective date:

- An entity need not reassess whether any expired or existing contracts contain leases.
- An entity need not reassess the lease classification for any expired or existing leases.
- An entity need not reassess initial direct costs for any existing leases.

The Company also elected the practical expedient, which must be applied consistently to all leases, to use hindsight in determining the lease term and in assessing impairment of our right-of-use assets. We also elected a practical expedient to not assess whether existing or expired land easements that were not previously accounted for as leases under Topic 840 contain a lease under this Topic. Both of these practical expedients may be elected separately or in conjunction with each other or the package noted above.

Kentucky Bancshares adopted the amendments of ASU 2016-02 as of January 31, 2019. At adoption, Kentucky Bancshares will recognize a lease asset and a corresponding lease liability on its consolidated balance sheet for its total lease obligation measured on a discounted basis estimated to be within a range of approximately $6.2 to $6.6 million.

As of December 31, 2018, all leases in which Kentucky Bancshares was the lessee were classified as operating leases. The adoption of this standard will not have a material impact on the Company's consolidated statements of income, balance sheet or regulatory capital as the Company has an immaterial amount of leases in which it is the lessee.

ASU 2016-01, "Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities (An Amendment of the FASB Accounting Standards Codification)." Issued in January 2016, ASU 2016-01 is intended to enhance the reporting model for financial instruments to provide users of financial statements with improved decision-making information. The amendments of ASU 2016-01 include: (i) requiring equity investments, except those accounted for under the equity method of accounting or those that result in the consolidation of an investee, to be measured at fair value with changes in fair value recognized in net income; (ii) requiring a qualitative assessment to identify impairment of equity investments without readily determinable fair values; (iii) eliminating the requirement to disclose the method and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost on the balance sheet; (iv) requiring the use of the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (v) requiring an entity that has elected the fair value option to measure the fair value of a liability to present separately in other comprehensive income the portion of the change in the fair value resulting from a change in the instrument-specific credit risk; (vi) requiring separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (vii) clarifying that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available for sale securities in combination with the entity's other deferred tax assets. The amendments of ASU 2016-01 are effective for interim and annual periods beginning after December 15, 2017. Kentucky Bancshares adopted the amendments of ASU 2016-01 during the first quarter of 2018. The adoption of this amendment did not have a material impact on the Company's consolidated financial statements.

ASU 2014-09, Revenue from Contracts with Customers: On January 1, 2018, the Company adopted ASU 2014-09 *Revenue from Contracts with Customers* and all subsequent ammendments to the ASU (collectively, "ASC 606"), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets. The majority of the Company's revenues come from interest income and other sources, including loans and securities, that are outside the scope of ASC 606. The Company's services that fall within the scope of ASC 606 are presented within Non-Interest Income and are recognized as revenue as the Company satisifies its obligation to the customer. Services within the scope of ASC 606 include trust department income, service charges, debit card interchange income and brokerage income.

- Trust department income: We earn wealth management fees based upon asset custody, investment management, trust, and estate services provided to customers. Most of these customers receive monthly billings for services rendered based upon the market value of assets and/or income generated. Fees that are transaction based are recognized at the point in time that the transaction is executed. These fees totaled $1.3 million in 2018.

- Service charges: We earn fees from our deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees and overdraft fees are recognized at a point in time, since the customer generally has a right to cancel the depository arrangement at any time. The arrangement is considered a day-to-day contract with ongoing renewals and optional purchases, so the duration of the contract does not extend beyond the services already performed. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which we satisfy our performance obligation. These fees totaled $5.3 million in 2018.

- Debit card interchange income: As with the transaction-based fees on deposit accounts, debit card interchange income is recognized at the point in time that we fulfill the customer's request. We earn interchange fees from cardholder transactions processed through card association networks. Interchange rates are generally set by the card associations based upon purchase volumes and other factors.

  Interchange fees represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder. These fees totaled $3.3 million in 2018.

- Brokerage income: Brokerage income fees are the commissions and fees received from a registered broker/dealer and investment adviser that provide those services to our customers. We act as an agent in arranging the relationship between the customer and the third-party service provider. These fees are recognized monthly from the third-party broker based upon services already performed. These fees totaled $665 thousand in 2018.

The Companny adopted ASC 606 using the modified retrospective method applied to all contracts not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606 while prior period amounts continue to be reported in accordance with legacy GAAP. The adoption of ASC 606 did not result in a change to the accounting for any of the in-scope revenue streams; as such, no cumulative adjustment was recorded.

ASU 2018-07, Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting. Issued in June 2018, the amendments in ASU 2018-07 to Topic 718, Compensation-Stock Compensation, are intended to align the accounting for share-based payment awards issued to employees and nonemployees.

Changes to the accounting for nonemployee awards include: 1) equity classified share-based payment awards issued to nonemployees will now be measured on the grant date, instead of the previous requirement to remeasure the awards through the performance completion date; 2) for performance conditions, compensation cost associated with the award will be recognized when achievement of the performance condition is probable, rather than upon achievement of the performance condition; and 3) the current requirement to reassess the classification (equity or liability) for nonemployee awards upon vesting will be eliminated, except for awards in the form of convertible instruments.

The new guidance also clarifies that any share-based payment awards issued to customers should be evaluated under ASC 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.

The Company's share-based payment awards to nonemployees consist only of grants made to the Company's Board of Directors as compensation solely related to the individual's role as a Director. As such, in accordance with ASC 718, the Company accounts for these share-based payment awards to its Directors in the same manner as share-based payment awards for its employees. Accordingly, the amendments in this guidance will not have an effect on the accounting for the Company's share-based payment awards to its Directors.

NOTE 2 - RESTRICTIONS ON CASH AND DUE FROM BANKS

Included in cash and due from banks are certain interest bearing deposits that are held at the Federal Reserve or maintained in vault cash in accordance with average balance requirements specified by the Federal Reserve Board of Governors. The reserve requirement was $4.5 million at December 31, 2018 and $2.1 million at December 31, 2017.

NOTE 3 - SECURITIES AVAILABLE FOR SALE

The following table summarizes the amortized cost and fair value of the securities at December 31, 2018 and 2017 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for Sale				
December 31, 2018				
U.S. treasury notes	$ 4,032	$ —	$ (57)	$ 3,975
U. S. government agencies	41,122	515	(459)	41,178
States and political subdivisions	64,196	503	(495)	64,204
Mortgage-backed - residential	150,704	159	(3,614)	147,249
Mortgage-backed - commercial	49,484	—	(921)	48,563
Asset-backed	10,234	56	(90)	10,200
Total	$ 319,772	$ 1,233	$ (5,636)	$315,369
December 31, 2017				
U.S. treasury notes	$ 4,046	$ —	$ (22)	$ 4,024
U. S. government agencies	41,658	405	(358)	41,705
States and political subdivisions	81,726	1,783	(127)	83,382
Mortgage-backed - residential	132,664	43	(2,330)	130,377
Mortgage-backed - commercial	52,267	18	(689)	51,596
Asset-backed	6,759	—	(6)	6,753
Equity securities	320	20	—	340
Total	$ 319,440	$ 2,269	$ (3,532)	$318,177

The amortized cost and fair value of securities at December 31, 2018, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity are shown separately.

	Amortized Cost	Fair Value
Due in one year or less	$ —	$ —
Due after one year through five years	48,012	48,206
Due after five years through ten years	22,126	21,937
Due after ten years	39,212	39,214
	109,350	109,357
Mortgage-backed - residential	150,704	147,249
Mortgage-backed - commercial	49,484	48,563
Asset-backed	10,234	10,200
Total	$ 319,772	$ 315,369

Proceeds from sales of securities during 2018, 2017 and 2016 were $26.7 million, $27.1 million and $23.9 million. Gross gains of $82 thousand, $115 thousand, and $317 thousand and gross losses of $147 thousand, $63 thousand and $30 thousand, were realized on those sales, respectively. The tax provision related to these realized gains and losses was $(14) thousand, $18 thousand and $98 thousand, respectively.

Securities with an approximate carrying value of $264.1 million and $260.4 million at December 31, 2018 and 2017, were pledged to secure public deposits, trust funds, securities sold under agreements to repurchase and for other purposes as required or permitted by law.

Securities with unrealized losses at year end 2018 and 2017 not recognized in income are as follows:

December 31, 2018

	Less than 12 Months		12 Months or More		Total	
Description of Securities	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
U.S. treasury notes	$ —	$ —	$ 3,975	$ (57)	$ 3,975	$ (57)
U.S. government agencies	—	—	21,102	(459)	21,102	(459)
States and municipals	8,007	(125)	25,540	(370)	33,547	(495)
Mortgage-backed - residential	19,250	(144)	112,369	(3,470)	131,619	(3,614)
Mortgage-backed - commercial	—	—	45,949	(921)	45,949	(921)
Asset-backed	1,920	(90)	—	—	1,920	(90)
Total temporarily impaired	$ 29,177	$ (359)	$ 208,935	$ (5,277)	$ 238,112	$ (5,636)

December 31, 2017

	Less than 12 Months		12 Months or More		Total	
Description of Securities	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
U.S. treasury notes	$ 4,024	$ (22)	$ —	$ —	$ 4,024	$ (22)
U.S. government agencies	18,405	(130)	12,692	(228)	31,097	(358)
States and municipals	8,689	(91)	2,769	(36)	11,458	(127)
Mortgage-backed - residential	70,646	(817)	54,760	(1,513)	125,406	(2,330)
Mortgage-backed - commercial	39,394	(409)	7,371	(280)	46,765	(689)
Asset-backed	6,753	(6)	—	—	6,753	(6)
Total temporarily impaired	$ 147,911	$ (1,475)	$ 77,592	$ (2,057)	$ 225,503	$ (3,532)

The Company evaluates securities for other than temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. In analyzing an issuer's financial condition, the Company may consider whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

Unrealized losses on securities have not been recognized into income because the issues are of high credit quality, management does not intend to sell and it is more likely than not that management would be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates. The fair value is expected to recover as the securities approach maturity.

At December 31, 2018, one U.S. treasury note has an unrealized loss of 1.4% from its amortized cost basis, ten U.S. government agency securities have unrealized losses of 2.1% from their amortized cost, twenty-one commercial mortgage backed securities have unrealized losses of 2.0% from their amortized cost basis, seventy-five residential mortgage backed securities have unrealized losses of 2.7% from their amortized cost basis, forty-seven states and municipals have unrealized losses of 1.5% from their amortized cost basis and one asset-backed security which has an unrealized loss of 4.5%. Management believes the declines in fair value from these and other securities are largely due to changes in interest rates. The Company believes there is no other-than-temporary impairment and does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery.

At both December 31, 2018 and December 31, 2017, the Company held no trading assets.

NOTE 4 - LOANS

Loans at year-end were as follows:

	12/31/2018	12/31/2017
Commercial	$ 86,149	$ 80,070
Real estate construction	24,254	20,816
Real estate mortgage:		
1-4 family residential	252,318	238,121
Multi-family residential	46,403	39,926
Non-farm & non-residential	196,674	192,074
Agricultural	60,049	59,176
Consumer	20,089	18,182
Other	208	170
Total	$ 686,144	$ 648,535

The following table presents the activity in the allowance for loan losses by portfolio segment for the years ending December 31, 2018, 2017 and 2016:

December 31, 2018	Beginning Balance	Charge-offs	Recoveries	Provision	Ending Balance
Commercial	$ 975	$ (23)	$ 10	$ 197	$ 1,159
Real estate Construction	462	—	—	(48)	414
Real estate mortgage:					
1-4 family residential	2,316	(98)	272	115	2,605
Multi-family residential	640	—	10	83	733
Non-farm & non-residential	1,554	(31)	—	126	1,649
Agricultural	494	—	191	(265)	420
Consumer	582	(285)	51	62	410
Other	18	(823)	633	230	58
Unallocated	679	—	—	—	679
	$ 7,720	$ (1,260)	$ 1,167	$ 500	$ 8,127

December 31, 2017	Beginning Balance	Charge-offs	Recoveries	Provision	Ending Balance
Commercial	$ 789	$ (35)	$ 19	$ 202	$ 975
Real estate Construction	564	—	1	(103)	462
Real estate mortgage:					
1-4 family residential	2,301	(249)	20	244	2,316
Multi-family residential	581	—	181	(122)	640
Non-farm & non-residential	1,203	(42)	—	393	1,554
Agricultural	856	—	57	(419)	494
Consumer	547	(205)	59	181	582
Other	60	(871)	744	85	18
Unallocated	640	—	—	39	679
	$ 7,541	$ (1,402)	$ 1,081	$ 500	$ 7,720

December 31, 2016	Beginning Balance	Charge-offs	Recoveries	Provision	Ending Balance
Commercial	$ 486	$ (5)	$ 39	$ 269	$ 789
Real estate Construction	411	—	15	138	564
Real estate mortgage:					—
1-4 family residential	2,081	(126)	19	327	2,301
Multi-family residential	458	—	12	111	581
Non-farm & non-residential	1,213	—	454	(464)	1,203
Agricultural	678	(193)	50	321	856
Consumer	525	(298)	80	240	547
Other	60	(908)	731	177	60
Unallocated	609	—	—	31	640
	$ 6,521	$ (1,530)	$ 1,400	$ 1,150	$ 7,541

The following tables present the balance in the allowance for loan losses and the recorded investment (excluding accrued interest receivable amounting to $2.8 million and $2.6 million) in loans by portfolio segment and based on impairment method as of December 31, 2018 and December 31, 2017:

As of December 31, 2018	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
Allowance for Loan Losses:			
Commercial	$ 191	$ 968	$ 1,159
Real estate construction	—	414	414
Real estate mortgage:			
1-4 family residential	10	2,595	2,605
Multi-family residential	—	733	733
Non-farm & non-residential	—	1,649	1,649
Agricultural	—	420	420
Consumer	—	410	410
Other	—	58	58
Unallocated	—	679	679
	$ 201	$ 7,926	$ 8,127
Loans:			
Commercial	$ 191	$ 85,958	$ 86,149
Real estate construction	374	23,880	24,254
Real estate mortgage:			
1-4 family residential	1,003	251,315	252,318
Multi-family residential	1,973	44,430	46,403
Non-farm & non-residential	227	196,447	196,674
Agricultural	1,164	58,885	60,049
Consumer	—	20,089	20,089
Other	—	208	208
Total	$ 4,932	$ 681,212	$ 686,144

As of December 31, 2017	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
Allowance for Loan Losses:			
Commercial	$ —	$ 975	$ 975
Real estate construction	—	462	462
Real estate mortgage:			
1-4 family residential	23	2,293	2,316
Multi-family residential	—	640	640
Non-farm & non-residential	—	1,554	1,554
Agricultural	—	494	494
Consumer	—	582	582
Other	—	18	18
Unallocated	—	679	679
	$ 23	$ 7,697	$ 7,720
Loans:			
Commercial	$ —	$ 80,070	$ 80,070
Real estate construction	—	20,816	20,816
Real estate mortgage:			
1-4 family residential	206	237,915	238,121
Multi-family residential	—	39,926	39,926
Non-farm & non-residential	1,130	190,944	192,074
Agricultural	284	58,892	59,176
Consumer	—	18,182	18,182
Other	—	170	170
Total	$ 1,620	$ 646,915	$ 648,535

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2018:

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With no related allowance recorded:						
Real estate construction	$ 374	$ 374	$ —	$ 187	$ 3	$ 3
Real estate mortgage:						
Multi-family residential	1,973	1,973	—	1,991	101	101
Non-farm & non-residential	227	227	—	679	12	$ 12
Agricultural	1,164	1,164	—	724	54	54
With an allowance recorded:						
Commercial	191	191	191	96	18	18
1-4 family residential	1,003	1,003	10	605	13	13
Total	$ 4,932	$ 4,932	$ 201	$ 4,282	$ 201	$ 201

The recorded investment in loans excludes accrued interest receivable and loan origination fees, net due to immateriality.

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2017:

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With no related allowance recorded:						
Non-farm & non-residential	$ 1,130	$ 1,130	$ —	$ 1,140	$ 68	$ 68
Agricultural	284	284	—	289	11	11
With an allowance recorded:						
1-4 family residential	206	206	23	208	8	8
Total	$ 1,620	$ 1,620	$ 23	$ 1,637	$ 87	$ 87

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2016:

	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With no related allowance recorded:			
Commercial	$ 48	$ 30	$ 30
Real estate construction	494	9	9
Real estate mortgage:			
1-4 family residential	488	—	—
Agricultural	561	—	—
With an allowance recorded:			
1-4 family residential	1,590	56	56
Non-farm & non-residential	2,303	71	71
Agricultural	3,309	25	25
Total	$ 8,793	$ 191	$ 191

The recorded investment in loans excludes accrued interest receivable and loan origination fees, net due to immateriality.

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

Nonaccrual loans secured by real estate make up 81.8% of the total nonaccrual loans.

If a loan is on nonaccrual status or past due over 89 days does not indicate if a loan was individually evaluated for a specific allowance for loss as certain conditions must be met for this evaluation to occur. Further, it is possible a loan that is on nonaccrual status or past due 89 days or greater was individually evaluated but deemed not impaired.

The following tables present the recorded investment in nonaccrual loans, loans past due over 89 days still accruing, and troubled debt restructurings by class of loans as of December 31, 2018 and 2017:

As of December 31, 2018	Nonaccrual	Loans Past Due Over 89 Days Still Accruing	Troubled Debt Restructurings
Commercial	$ 191	$ —	$ —
Real estate construction	—	374	
Real estate mortgage:			
1-4 family residential	525	784	—
Non-farm & non-residential	156	14	—
Agricultural	252	—	—
Consumer	17	10	—
Total	$ 1,141	$ 1,182	$ —

As of December 31, 2017	Nonaccrual	Loans Past Due Over 89 Days Still Accruing	Troubled Debt Restructurings
Commercial	$ —	$ 32	$ —
Real estate mortgage:			
1-4 family residential	1,086	184	—
Agricultural	96	—	—
Consumer	11	15	—
Total	$ 1,193	$ 231	$ —

The following tables present the aging of the recorded investment in past due and non-accrual loans as of December 31, 2018 and 2017 by class of loans:

December 31, 2018

	30–59 Days Past Due	60–89 Days Past Due	Greater than 89 Days Past Due	Non-accrual	Total Past Due & Non-accrual	Loans Not Past Due
Commercial	$ 10	$ 24	$ —	$ 191	$ 225	$ 85,924
Real estate construction	309	—	374	—	683	23,571
Real estate mortgage:						
1-4 family residential	2,158	563	784	525	4,030	248,288
Multi-family residential	951	—	—	—	951	45,452
Non-farm & non-residential	68	84	14	156	322	196,352
Agricultural	502	15	—	252	769	59,280
Consumer	119	15	10	17	161	19,928
Other	—	—	—	—	—	208
Total	$ 4,117	$ 701	$ 1,182	$ 1,141	$ 7,141	$ 679,003

December 31, 2017

	30–59 Days Past Due	60–89 Days Past Due	Greater than 89 Days Past Due	Non-accrual	Total Past Due & Non-accrual	Loans Not Past Due
Commercial	$ 678	$ 44	$ 32	$ —	$ 754	$ 79,316
Real estate construction	—	—	—	—	—	20,816
Real estate mortgage:						
1-4 family residential	2,222	321	184	1,086	3,813	234,308
Multi-family residential	—	—	—	—	—	39,926
Non-farm & non-residential	162	—	—	—	162	191,912
Agricultural	249	—	—	96	345	58,831
Consumer	132	14	15	11	172	18,010
Other	—	—	—	—	—	170
Total	$ 3,443	$ 379	$ 231	$ 1,193	$ 5,246	$ 643,289

Troubled Debt Restructurings:

At December 31, 2018 and 2017, the Company did not have any loans designated as troubled debt restructurings.

For the years ending December 31, 2018, 2017 and 2016, no loans modified as troubled debt restructurings defaulted on payment.

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes primarily non-homogeneous loans with an outstanding balance greater than $200 thousand such as commercial and commercial real estate loans. This analysis is performed on a quarterly basis. The Company uses the following definitions for risk ratings:

Special Mention. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. The following tables present the risk category of loans by class of loans, based on the most recent analysis performed, as of December 31, 2018 and 2017:

December 31, 2018

	Pass	Special Mention	Substandard	Doubtful
Commercial	$ 84,911	$ 994	$ 53	$ 191
Real estate construction	23,857	—	397	—
Real estate mortgage:				
1-4 family residential	244,382	2,685	5,201	50
Multi-family residential	43,248	1,182	1,973	—
Non-farm & non-residential	188,186	7,967	503	18
Agricultural	54,654	3,715	1,680	—
Total	$ 639,238	$ 16,543	$ 9,807	$ 259

December 31, 2017

	Pass	Special Mention	Substandard	Doubtful
Commercial	$ 78,326	$ 1,703	$ 41	$ —
Real estate construction	20,816	—	—	—
Real estate mortgage:				
1-4 family residential	230,103	3,522	4,496	—
Multi-family residential	36,654	2,551	721	—
Non-farm & non-residential	183,230	7,240	1,604	—
Agricultural	54,765	3,682	729	—
Total	$ 603,894	$ 18,698	$ 7,591	$ —

For consumer loans, the Company evaluates the credit quality based on the aging of the recorded investment in loans, which was previously presented. Non-performing consumer loans are loans which are greater than 89 days past due or on non-accrual status, and total $27 thousand at December 31, 2018 and $26 thousand at December 31, 2017.

Non-consumer loans with an outstanding balance less than $200 thousand are evaluated similarly to consumer loans. Loan performance is evaluated based on delinquency status. Both are reviewed at least quarterly and credit quality grades are updated as needed.

Certain directors and executive officers of the Company and companies in which they have beneficial ownership were loan customers of the Bank during 2018 and 2017. An analysis of the activity with respect to all director and executive officer loans is as follows:

	2018	2017
Balance, beginning of year	$ 930	$ 1,148
New loans	14	124
Repayments	(116)	(342)
Balance, end of year	$ 828	$ 930

Loan Servicing

Mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of mortgage loans serviced for others were approximately $217.0 million and $220.3 million at December 31, 2018 and 2017.
Custodial escrow balances maintained in connection with the foregoing loan servicing, and included in demand deposits, were approximately $977 thousand and $980 thousand at December 31, 2018 and 2017.

Activity for mortgage servicing rights and the related valuation allowance follows:

	2018	2017	2016
Servicing Rights:			
Beginning balance	$ 1,511	$ 1,321	$ 1,277
Additions	335	436	483
Amortization	(327)	(315)	(334)
Change in valuation allowance	17	69	(105)
Ending balance	$ 1,536	$ 1,511	$ 1,321
Valuation Allowance:			
Beginning balance	$ 56	$ 125	$ 20
Additions expensed	39	5	109
Reductions credited to operations	56	74	4
Ending balance	$ 39	$ 56	$ 125

The fair value of servicing rights was $2.1 million at both year-end 2018 and 2017. Fair value at year-end 2018 was determined using a discount rate of 12.0%, prepayment speeds ranging from 6.6% to 25.0%, depending on the stratification of the specific right, and default rates ranging from 0.1% to 0.9%. Fair value at year-end 2017 was determined using a discount rate of 12.0%, prepayment speeds ranging from 7.3% to 25.0%, depending on the stratification of the specific right, and default rates ranging from 0.1% to 0.9%.

The weighted average amortization period is 20.7 years. Estimated amortization expense for each of the next five years is:

2019	$ 149
2020	125
2021	106
2022	77
2023	67

NOTE 5 - REAL ESTATE OWNED

Activity in real estate owned was as follows:

	Year Ended December 31, 2018	Year Ended December 31, 2017
Beginning of year	$ 2,404	$ 1,824
Additions	201	1,897
Capitalized Expenditures	74	47
Sales	(1,849)	(1,344)
Fair value adjustments	—	(20)
End of period	$ 830	$ 2,404

Activity in the valuation allowance was as follows:

	2018	2017	2016
Beginning of year	$ 777	$ 803	$ 616
Fair value adjustments	—	20	187
Reductions from sale	(370)	(46)	—
End of Period	$ 407	$ 777	$ 803

Expenses related to foreclosed assets include:

	Year Ended December 31, 2018	2017	2016
Net gains on sales, included in other expense on income statement	$ (173)	$ (33)	$ (128)
Fair value adjustments	—	20	187
Operating expenses, net of rental income	98	188	214
Repossession expense, net	98	208	401
Net expense, net of gain or loss on sales, for the period	$ (75)	$ 175	$ 273

NOTE 6 - PREMISES AND EQUIPMENT

Year-end premises and equipment were as follows:

	2018	2017
Land and buildings	$ 22,090	$ 20,569
Furniture and equipment	19,363	18,392
Construction in process	66	504
	41,519	39,465
Less accumulated depreciation	(24,170)	(22,926)
	$ 17,349	$ 16,539

Depreciation expense was $1.2 million, $1.2 million and $1.3 million in 2018, 2017, and 2016.

Certain premises, not included in premises and equipment above, are leased under operating leases. The approximate future minimum lease payments due under the aforementioned operating leases for their base term are as follows:

2019	$ 423
2020	409
2021	397
2022	361
2023	251
Thereafter	1,617
	$ 3,458

NOTE 7 - GOODWILL AND INTANGIBLE ASSETS

The change in balance for goodwill during the year is as follows:

	2018	2017	2016
Beginning of year	$ 14,001	$ 14,001	$ 14,001
Acquired goodwill	—	—	—
Impairment	—	—	—
End of year	$ 14,001	$ 14,001	$ 14,001

Goodwill is not amortized but instead evaluated periodically for impairment.

Impairment exists when a reporting unit's carrying value of goodwill exceeds its fair value, which is determined through a two-step impairment test. Step 1 includes the determination of the carrying value of our single reporting unit, including the existing goodwill and intangible assets, and estimating the fair value of the reporting unit. We determined the fair value of our reporting unit and compared it to its carrying amount. If the carrying amount of a reporting unit exceeds its fair value, we are required to perform a second step to the impairment test.

Our annual impairment analysis as of December 31, 2018 indicated that the Step 2 analysis was not necessary. If needed, Step 2 of the goodwill impairment test is performed to measure the impairment loss. Step 2 requires that the implied fair value of the reporting unit goodwill be compared to the carrying amount of that goodwill. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss shall be recognized in an amount equal to that excess.

Acquired intangible assets were as follows at year-end:

	2018		2017	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:				
Core deposit intangibles	$ 800	$ 562	$ 800	$ 431

Aggregate amortization expense was $131 thousand, $160 thousand and $247 thousand for 2018, 2017 and 2016.

Estimated amortization expense for each of the next five years:

2019	$ 102
2020	74
2021	45
2022	17
2023	—

NOTE 8 - DEPOSITS

Time deposits of $250 thousand or more were $59.7 million and $79.6 million at year-end 2018 and 2017, respectively.

At December 31, 2018, the scheduled maturities of time deposits for the next five years are as follows:

2019	$ 136,121
2020	27,782
2021	14,182
2022	7,940
2023	5,970

Certain directors and executive officers of the Company and companies in whom they have beneficial ownership are deposit customers of the Bank. These deposits totaled approximately $2.1 million and $2.9 million at December 31, 2018 and 2017.

NOTE 9 - REPURCHASE AGREEMENTS AND OTHER BORROWINGS

Securities sold under agreements to repurchase are secured by U.S. Government agency securities and mortgage-backed securities with a total carrying amount of $13.9 million and $26.5 million at year-end 2018 and 2017.

Repurchase agreements range in maturities from 1 day to 29 months. The securities underlying the agreements are maintained in a third-party custodian's account under a written custodial agreement. Information concerning repurchase agreements for 2018, 2017 and 2016 is summarized as follows:

	2018	2017	2016
Average daily balance during the year	$ 9,313	$ 21,989	$ 23,755
Average interest rate during the year	0.67 %	0.47 %	0.45 %
Maximum month-end balance during the year	$ 9,751	$ 24,070	$ 27,214
Weighted average interest rate at year end	0.60 %	0.52 %	0.50 %

On July 20, 2015, the Company borrowed $5 million which had paid down to $2.7 million at December 31, 2018 and $3.3 million at December 31, 2017. The term loan has a fixed interest rate of 5.02%, requires quarterly principal and interest payments, matures July 20, 2025 and is collateralized by Kentucky Bank stock. The maturity schedule for the term loan as of December 31, 2018 is as follows:

2019	$ 513
2020	539
2021	567
2022	596
Thereafter	503
	$ 2,718

NOTE 10 - FEDERAL HOME LOAN BANK ADVANCES

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

	2018	2017
Short-Term Advances		
Maturities in March and July 2019 with fixed rates of 2.56% and 2.58%	**$** 11,600	**$** 8,400
Long-Term Advances		
Maturities range from January 2019 through March 2030, fixed rates from 1.40% to 5.37%, averaging 2.05% in 2018 and 1.82% in 2017	88,852	90,332

Advances are paid either on a monthly basis or at maturity. All advances require a prepayment penalty, and are secured by the Federal Home Loan Bank stock and substantially all 1-4 family first-mortgage residential, multi-family and farm real estate loans under a blanket lien arrangement at December 31, 2018 and 2017. Based on this collateral and the Company's holding of Federal Home Loan Bank stock, the Company is eligible to borrow up to an additional $75.4 million at December 31, 2018.

Scheduled principal payments due on advances during the years subsequent to December 31, 2018 are as follows:

2019	$ 28,132
2020	20,332
2021	14,662
2022	18,501
2023	9,446
Thereafter	9,379
	$ 100,452

NOTE 11 - SUBORDINATED DEBENTURES

In August 2003, the Company formed Kentucky Bancshares, Statutory Trust I ("Trust"). The Trust issued $217 thousand of common securities to the Company and $7 million of trust preferred securities as part of a pooled offering of such securities. The Company issued $7.2 million subordinated debentures to the Trust in exchange for the proceeds of the offering, which debentures represent the sole asset of the Trust. The debentures paid interest quarterly at 7.06% for the first 5 years. Starting September 2008, the rate converted to three-month LIBOR plus 3.00% adjusted quarterly, which was 5.79% at year-end 2018. The Company is not considered the primary beneficiary of this Trust (variable interest entity), therefore the trust is not consolidated in the Company's financial statements, but rather the subordinated debentures are shown as a liability.

The Company may redeem the subordinated debentures, in whole or in part, beginning September 2008 at a price of 100% of face value. The subordinated debentures must be redeemed no later than 2033. The Company has the option to defer interest payments on the subordinated debentures from time to time for a period not to exceed five consecutive years.

The subordinated debentures may be included in Tier I capital (with certain limitations applicable) under current regulatory guidelines and interpretations.

NOTE 12 - INCOME TAXES

Income tax expense was as follows:

	2018	2017	2016
Current	$ 1,489	$ 2,748	$ 1,082
Adjustment for Tax Cuts and Jobs Act	—	443	—
Deferred	165	(28)	(309)
	$ 1,654	$ 3,163	$ 773

Year-end deferred tax assets and liabilities were due to the following. No valuation allowance for the realization of deferred tax assets is considered necessary.

	2018	2017
Deferred tax assets		
Allowance for loan losses	$ 1,722	$ 1,637
Other real estate owned	32	106
Nonaccrual loan interest	14	36
Accrued expenses	162	134
Acquisition market value adjustments	118	230
Capital loss carryforward	—	73
Unrealized loss on securities	925	265
Low income housing investments	189	124
Unearned income	135	190
Other	80	69
Deferred tax liabilities		
Bank premises and equipment	(716)	(640)
FHLB stock	(808)	(808)
Prepaid expenses	(213)	(168)
Mortgage servicing rights	(323)	(309)
Core deposit intangibles	(50)	(78)
Acquisition loan loss recapture	—	(53)
Other	(57)	(92)
Net deferred tax asset (liability)	$ 1,210	$ 716

Effective tax rates differ from federal statutory rates applied to financial statement income due to the following:

	2018	2017	2016
U. S. federal income tax rate	21.0 %	34.0 %	34.0 %
Changes from the statutory rate			
Tax-exempt interest income	(4.4)	(9.0)	(14.1)
Historic and low income tax credits	(4.0)	(4.0)	(9.4)
Insurance captive	(1.0)	(1.9)	(3.3)
Non-deductible interest expense related to carrying tax-exempt investments	0.2	0.3	0.4
2017 Tax Cuts and Jobs Act	—	3.1	—
Other	(0.1)	0.3	0.7
	11.7 %	22.8 %	8.3 %

On December 22, 2017, the 'Tax Cuts and Jobs Act' was enacted into legislation. Under ASC 740, the effects of changes in tax rates and laws were recognized in the period in which the new legislation was enacted. Accordingly, in 2017, the Company recorded an estimated $443 thousand for the revaluation of the Company's deferred tax assets to estimate the revaluation of deferred tax assets due to the lowering of the federal corporate tax rate to 21%.

At December 31, 2017, the Company early adopted ASU 2018-02 and reclassified out of retained earnings and into accumulated other comprehensive income $164 thousand of tax expense that was recorded to income tax expense at December 31, 2017 due to re-measuring to 21% deferred taxes on available for sale securities

Federal income tax laws provided the First Federal Savings Bank, acquired by the Company in 2003, with additional bad debt deductions through 1987, totaling $1.3 million. Accounting standards do not require a deferred tax liability to be recorded on this amount, which otherwise would total a $272 thousand liability at December 31, 2018. The Company's acquisition of First Federal Savings Bank did not require the recapture of the bad debt reserve. However, if Kentucky Bank was liquidated or otherwise ceased to be a bank, or if tax laws were to change, the $272 thousand would be recorded as expense.

Unrecognized Tax Benefits

The Company does not have any beginning and ending unrecognized tax benefits. The Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months.

There were no interest and penalties recorded in the income statement or accrued for the years ended December 31, 2018 and 2017.

The Company and its subsidiaries file a consolidated U.S. Corporation income tax return and a corporate income tax return in the state of Kentucky. The Company is no longer subject to examination by taxing authorities for years before 2015.

NOTE 13 - EARNINGS PER SHARE

The factors used in the earnings per share computation follow:

	2018	2017	2016
Basic and Diluted Earnings Per Share			
Net income	$ 12,430	$ 10,717	$ 8,569
Weighted average common shares outstanding	5,924	5,944	5,982
Basic and diluted earnings per share	$ 2.09	$ 1.81	$ 1.43

Stock options of 0 shares common stock from 2018, 1,200 shares common stock from 2017 and 2,400 shares common stock from 2016 were excluded from diluted earnings per share because their impact was antidilutive. Restricted stock grants for 2018, 2017 and 2016 were excluded in shares outstanding for purposes of computing basic and diluted earnings per share.

See Note 1 in the notes to the consolidated financial statements for more detail on the stock split.

NOTE 14 - RETIREMENT PLAN

The Company has a qualified profit sharing plan which covers substantially all employees and includes a 401 (k) provision. Profit sharing contributions, excluding the 401(k) provision, are at the discretion of the Company's Board of Directors. Expense recognized in connection with the plan was $916 thousand, $939 thousand and $925 thousand in 2018, 2017 and 2016.

NOTE 15 - STOCK BASED COMPENSATION

The Company has three share based compensation plans as described below. Total compensation cost that has been charged against income for those plans was $175 thousand, $163 thousand, and $153 thousand for 2018, 2017 and 2016.

1993 Stock Option Plan

Under the expired 1993 Non-Employee Directors Stock Ownership Incentive Plan, the Company had granted certain directors stock option awards which vest and become fully exercisable immediately and provided for issuance of up to 40,000 options. The exercise price of each option, which has a ten year life, was equal to the market price of the Company's stock on the date of grant.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses various assumptions. Expected volatilities are based on historical volatilities of the Company's common stock. The Company uses historical data to estimate option exercise and post-vesting termination behavior.

The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. No options were granted in 2018, 2017 or 2016.

Summary of activity in the expired stock option plan for 2018 follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, beginning of year	1,200	$ 15.50		
Exercised	(1,200)	15.50		
Outstanding, end of period	—	$ —	0 months	$ —
Vested and expected to vest	—	$ —	0 months	$ —
Exercisable, end of period	—	$ —	0 months	$ —

As of December 31, 2018, there was $0 of total unrecognized compensation cost related to nonvested stock options granted under the Plan. Since the stock option plan has expired, as of December 31, 2018, no additional options will be issued.

2005 Restricted Stock Grant Plan

Under the Company's expired 2005 Restricted Stock Grant Plan, total shares issuable under the plan were 100,000. There were no shares issued during 2018 and 2017. There were 178 shares forfeited during 2018 and 294 shares forfeited during 2017. Since the plan has expired, as of December 31, 2018, no additional restricted stock share awards will be issued.

A summary of changes in the Company's nonvested shares for the year follows:

Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value	Fair Value Per Share
Nonvested at January 1, 2018	12,282	$ 151,984	$ 12.37
Vested	(6,180)	(72,224)	11.69
Forfeited	(178)	(2,356)	13.24
Nonvested at December 31, 2018	5,924	$ 77,404	$ 13.07

As of December 31, 2018, the total unrecognized compensation cost related to nonvested shares granted under the Plan is expected to be recognized over a weighted-average period of 1.0 year. The total grant-date fair value of shares vested during the years ended December 31, 2018, 2017 and 2016 was $72 thousand, $98 thousand and $128 thousand.

2009 Stock Award Plan

On May 13, 2009, the Company's stockholders approved a stock award plan that provides for the granting of both incentive and nonqualified stock options, restricted stock share awards and other share based awards. Total shares issuable under the plan are 300,000. There were 11,440 shares issued during 2018 and 13,150 shares issued during 2017. There were 2,226 shares forfeited during 2018 and 2,188 shares forfeited during 2017. As of December 31, 2018, the 2009 stock award plan allows for additional restricted stock share awards of up to 256 thousand shares.

A summary of changes in the Company's nonvested shares for the year follows:

Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value	Fair Value Per Share
Nonvested at January 1, 2018	21,860	$ 338,545	$ 15.49
Granted	11,440	263,406	23.03
Vested	(5,296)	(80,538)	15.21
Forfeited	(2,226)	(39,200)	17.61
Nonvested at December 31, 2018	25,778	$ 482,213	$ 18.71

As of December 31, 2018 the total unrecognized compensation cost related to nonvested shares granted under the Plan is expected to be recognized over a weighted-average period of 3.4 years. The total grant-date fair value of shares vested during the years ended December 31, 2018, 2017 and 2016 was $81 thousand, $54 thousand and $15 thousand.

See Note 1 in the notes to the consolidated financial statements for more detail on the stock split.

NOTE 16 - LIMITATION ON BANK DIVIDENDS

The Company's principal source of funds is dividends received from the Bank. Banking regulations limit the amount of dividends that may be paid by the Bank without prior approval of regulatory agencies. Under these regulations, the amount of dividends that may be paid in any calendar year is limited to the current year's net profits, as defined, combined with the retained net profits of the preceding two years. During 2019 the Bank could, without prior approval, declare dividends on any 2019 net profits retained to the date of the dividend declaration plus $9.1 million.

NOTE 17 - FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

> Level 1 — Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
>
> Level 2 — Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
>
> Level 3 — Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate the fair value:

<u>Securities Available for Sale</u>: The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2).

For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

<u>Equity Securities</u>: The fair values for equity securities are determined by quoted market prices, if available (Level 1). The Company has included equity securities in other asets on the Company's Balance Sheet as of December 31, 2018.

<u>Impaired Loans</u>: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted in accordance with the allowance policy.

Other Real Estate Owned: Assets acquired through, or instead of, loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals which are updated no less frequently than annually. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach.

Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Real estate owned properties are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Loan Servicing Rights: Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively based on a valuation model that calculates the present value of estimated future net servicing income, resulting in a Level 3 classification.

Assets and Liabilities Measured on a Recurring Basis

Available for sale investment securities and equity securities which are in included in other assets on the Company's balance sheet are the Company's only balance sheet item that meet the disclosure requirements for instruments measured at fair value on a recurring basis. Disclosures are as follows in the tables below.

December 31, 2018

Description	Carrying Value	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. treasury notes	$ 3,975	$ —	$ 3,975	$ —
U. S. government agencies	41,178	—	41,178	—
States and municipals	64,204	—	64,204	—
Mortgage-backed - residential	147,249	—	147,249	—
Mortgage-backed-commercial	48,563	—	48,563	—
Asset-backed	10,200	—	10,200	—
Other Assets	284	284	—	—
Total	$315,653	$ 284	$ 315,369	$ —

December 31, 2017

Description	Carrying Value	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. treasury notes	$ 4,024	$ —	$ 4,024	$ —
U. S. government agencies	41,705	—	41,705	—
States and municipals	83,382	—	83,382	—
Mortgage-backed - residential	130,377	—	130,377	—
Mortgage-backed - commercial	51,596	—	51,596	—
Asset-backed	6,753		6,753	
Equity securities	340	340	—	—
Total	$318,177	$ 340	$ 317,837	$ —

There were no transfers between level 1 and level 2 during 2018 or 2017.

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

	Fair Value Measurements at December 31, 2018 Using :			
Description	Carrying Value	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans:				
1-4 family residential	$ 993	$ —	$ —	$ 993
Other real estate owned, net:				
Commercial	246	—	—	246
Mortgage servicing rights	430	—	—	430

	Fair Value Measurements at December 31, 2017 Using :			
Description	Carrying Value	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans:				
Real Estate Mortgage:				
1-4 family residential	$ 183	$ —	$ —	$ 183
Other real estate owned, net:				
Residential	910	—	—	910
Commercial	200	—	—	200
Mortgage servicing rights	1,323	—	—	1,323

Impaired loans measured for impairment using the fair value of the collateral had a net carrying amount of $993 thousand, with a valuation allowance of $201 thousand at December 31, 2018. During 2018, eight new loans became impaired resulting in an additional provision for loan losses of $201 thousand. The total allowance for specific impaired loans increased $178 thousand for the year ending December 31, 2018.

At December 31, 2017, impaired loans measured for impairment using the fair value of the collateral had a net carrying amount of $183 thousand, with a valuation allowance of $23 thousand. One new loan became impaired during 2017 which resulted in an additional provision for loan losses of $23 thousand for the year ending December 31, 2017.

Other real estate owned measured at fair value less costs to sell, had a net carrying amount of $246 thousand, which is made up of the outstanding balance of $653 thousand, net of a valuation allowance of $407 thousand at December 31, 2018. Fair value adjustments of other real were $0 for the year ended December 31, 2018. At December 31, 2017, other real estate owned measured at fair value less costs to sell, had a net carrying amount of $1.1 million, which was made up of the outstanding balance of $1.9 million, net of a valuation allowance of $777 thousand at December 31, 2017. Fair value adjustments to other real estate owned netted to a write-down of $20 thousand for the year ended December 31, 2017.

Certain impaired loan servicing rights, which are carried at lower of cost or fair value, were carried at their fair value of $430 thousand, which is made up of the outstanding balance of $469 thousand, net of a valuation allowance of $39 thousand at December 31, 2018. Fair value adjustments for the loan servicing rights netted to a positive adjustment of $17 thousand for the year ended December 31, 2018. At December 31, 2017, impaired loan servicing rights were carried at their fair value of $1.3 million, which is made up of the outstanding balance of $1.4 million, net of a valuation allowance of $56 thousand at December 31, 2017. Fair value adjustments netted to a positve adjustment of $69 thousand for the year ended December 31, 2017.

The following table presents quantitative information about level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2018 and 2017:

December 31, 2018	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Impaired loans				
Real estate mortgage:				
1-4 family residential	$ 993	sales comparison	adjustment for differences between the comparable sales	(21)% - 7% (7)%
Other real estate owned:				
Commercial	246	income approach	capitalization rate	10% - 10% (10)%
Mortgage servicing rights	430	discounted cash flow	constant prepayment rates	7% - 25% (9)%

December 31, 2017	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Impaired loans				
Real estate mortgage:				
1-4 family residential	$ 183	sales comparison	adjustment for differences between the comparable sales	3% - 27% (15)%
Other real estate owned:				
Residential	910	sales comparison	adjustment for differences between the comparable sales	0% - 16% (6)%
Commercial	200	income approach	capitalization rate	10% - 10% (10)%
Mortgage Servicing Rights	1,323	discounted cash flow	constant prepayment rates	7% - 25% (10)%

Fair Value of Financial Instruments

The carrying amounts and estimated fair values of financial instruments, at December 31, 2018 and December 31, 2017 are as follows:

December 31, 2018:

	Carrying Value	Level 1	Level 2	Level 3	Total
Financial assets					
Cash and cash equivalents	$ 26,101	$ 26,101	$ —	$ —	$ 26,101
Interest bearing time deposits	2,175	2,175	—	—	2,175
Securities available for sale	315,369	—	315,369	—	315,369
Loans held for sale	1,203	—	1,224	—	1,224
Net Loans	678,017	—	—	666,942	666,942
Federal Home Loan Bank stock	7,034	—	—	—	N/A
Interest receivable	4,150	—	1,346	2,804	4,150
Financial liabilities					
Total deposits	$ 850,442	$ 620,885	$ 226,734	$ —	$ 847,619
Repurchase agreements	8,077	—	8,009	—	8,009
Short-term Federal Home Loan Bank advances	11,600	—	11,592	—	11,592
Long-term Federal Home Loan Bank advances	88,852	—	84,983	—	84,983
Note payable	2,718		2,841		2,841
Subordinated debentures	7,217	—	—	7,213	7,213
Interest payable	893	—	877	16	893

December 31, 2017:

	Carrying Value	Level 1	Level 2	Level 3	Total
Financial assets					
Cash and cash equivalents	$ 39,172	$ 39,172	$ —	$ —	$ 39,172
Interest bearing time deposits	1,830	1,830	—	—	1,830
Securities available for sale	318,177	340	317,837	—	318,177
Loans held for sale	1,231	—	1,269	—	1,269
Net Loans	640,815	—	—	639,421	639,421
Federal Home Loan Bank stock	7,034	—	—	—	—
Interest receivable	3,951	—	1,378	2,573	3,951
Financial liabilities					
Total deposits	$ 815,273	$ 621,139	$ 195,143	$ —	$ 816,282
Repurchase agreements	19,900	—	19,968	—	19,968
Short-term Federal Home Loan Bank advances	8,400	—	8,393	—	8,393
Long-term Federal Home Loan Bank advances	90,332	—	86,899	—	86,899
Note payable	3,321	—	3,560	—	3,560
Subordinated debentures	7,217	—	—	7,212	7,212
Interest payable	838	—	825	13	838

The methods and assumptions, not previously presented, used to estimate fair value are described as follows: Carrying amount is the estimated fair value for cash and cash equivalents, interest bearing deposits, accrued interest receivable and payable, demand deposits, short-term debt, and variable rate loans or deposits that reprice frequently and fully. The methods for determining the fair values for securities were described previously. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk (including consideration of widening credit spreads). The methods used to determine the fair value of loans were based on the notion of exit price. Fair value of debt is based on current rates for similar financing. It was not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability. The fair value of off-balance sheet items is not considered material.

NOTE 18 - OFF-BALANCE SHEET ACTIVITIES AND COMMITMENTS

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

Financial instruments with off-balance sheet risk were as follows at year-end:

	2018		2017	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Unused lines of credit	$ —	$117,660	$ —	$98,413
Commitments to make loans	6,004	11,196	4,915	12,334
Letters of credit	—	552	—	672

Unused lines of credit are substantially all at variable rates. Commitments to make loans are generally made for a period of 60 days or less and are originated at current market rates ranging from 3.88% to 6.50% with maturities ranging up to 30 years.

NOTE 19 - CAPITAL REQUIREMENTS

The Bank and the Company were subject to regulatory capital requirements administered by the federal banking agencies in 2017. In August 2018, the Federal Reserve Board issued an interim final ruling that holding companies with assets less than $3 billion are not subject to minimum capital requirements. As a result, only Bank capital data and capital ratios are presented as of December 31, 2018.

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

The final rules implementing the Basel Committee on Banking Supervision's capital guidelines for US banks (Basel III rules) became effective for the Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under the Basell III rules, the Bank must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% by 2019. The capital conservation buffer for 2018 is 1.875% and was 1.25% for 2017. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital.

Management believes as of December 31, 2018, the Bank meets all capital adequacy requirements to which it is subject.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of Total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital to average assets (as defined). Management believes, as of December 31, 2018 and 2017, that the Bank meets all capital adequacy requirements to which they are subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restortation plans are required. At year-end 2018 and 2017, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum Total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed the institution's category.

The Bank's actual amounts and ratios, exclusive of the capital conservation buffer, are presented in the table below. Both the Bank's and Company's actual amounts and ratios, exclusive of the capital conservation buffer, are presented below as of December 31, 2017:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in Thousands)			
December 31, 2018						
Bank Only						
Total Capital (to Risk-Weighted Assets)	$ 105,345	14.7 %	$ 57,496	8.0 %	$ 71,870	10.0 %
Tier I Capital (to Risk-Weighted Assets)	97,143	13.5	43,122	6.0	57,496	8.0
Common Equity Tier 1 Capital (to Risk-Weighted Assets)	97,143	13.5	32,341	4.5	46,715	6.5
Tier I Capital (to Average Assets)	97,143	9.2	42,348	4.0	53,047	5.0
December 31, 2017						
Consolidated						
Total Capital (to Risk-Weighted Assets)	$ 101,896	14.9 %	$ 54,599	8.0 %	$ N/A	N/A
Tier I Capital (to Risk-Weighted Assets)	94,092	13.8	40,949	6.0	N/A	N/A
Common Equity Tier 1 Capital (to Risk-Weighted Assets)	87,092	12.8	30,712	4.5	N/A	N/A
Tier I Capital (to Average Assets)	94,092	9.2	40,754	4.0	N/A	N/A
December 31, 2017						
Bank Only						
Total Capital (to Risk-Weighted Assets)	$ 99,688	14.6 %	$ 54,581	8.0 %	$ 68,226	10.0 %
Tier I Capital (to Risk-Weighted Assets)	91,884	13.5	40,936	6.0	54,581	8.0
Common Equity Tier 1 Capital (to Risk-Weighted Assets)	91,884	13.5	30,702	4.5	44,347	6.5
Tier I Capital (to Average Assets)	91,884	9.0	40,669	4.0	50,836	5.0

NOTE 20 - PARENT COMPANY FINANCIAL STATEMENTS

Condensed Balance Sheets
As of December 31,

	2018	2017
ASSETS		
Cash on deposit with subsidiaries	$ 6,793	$ 3,563
Investment in subsidiaries	109,723	106,980
Securities available for sale	—	70
Other assets	228	310
Total assets	$ 116,744	$ 110,923
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Note payable	$ 2,718	$ 3,321
Subordinated debentures	7,217	7,217
Other Liabilities	16	56
Stockholders' equity		
Preferred stock	—	—
Common stock	21,170	20,931
Retained earnings	89,101	80,395
Accumulated other comprehensive income	(3,478)	(997)
Total liabilities and stockholders' equity	$ 116,744	$ 110,923

Condensed Statements of Income and Comprehensive Income
Years Ended December 31,

	2018	2017	2016
Income			
Dividends from subsidiary	$ 8,000	$ 7,135	$ 5,700
Securities (losses), net	(26)	—	—
Total income	7,974	7,135	5,700
Expenses			
Interest expense	518	500	482
Other expenses	240	216	209
Total expenses	758	716	691
Income before income taxes and equity in undistributed income of subsidiary	7,216	6,419	5,009
Applicable income tax benefits	165	262	235
Income before equity in undistributed income of subsidiary	7,381	6,681	5,244
Equity in undistributed income of subsidiaries	5,049	4,036	3,325
Net income	$ 12,430	$ 10,717	$ 8,569
Comprehensive income (loss)	$ 9,949	$ 10,840	$ 7,254

Condensed Statements of Cash Flows
Years Ended December 31,

	2018	2017	2016
Cash flows from operating activities			
Net income	$ 12,430	$ 10,717	$ 8,569
Adjustments to reconcile net income to net cash from operating activities			
Equity in undistributed earnings of subsidiary	(5,049)	(4,036)	(3,325)
Securities losses	26	—	—
Change in other assets	102	(23)	82
Change in other liabilities	(40)	3	43
Net cash from operating activities	7,469	6,661	5,369
Cash flows from investing activities			
Proceeds from sales of securities, available for sale	24	—	—
Net cash from investing activities	24	—	—
Cash flows from financing activities			
Payments on note payable	(603)	(769)	(704)
Dividends paid	(3,724)	(3,447)	(3,229)
Proceeds from issuance of common stock	64	64	49
Purchase of common stock	—	(263)	(668)
Net cash from financing activities	(4,263)	(4,415)	(4,552)
Net change in cash	3,230	2,246	817
Cash at beginning of year	3,563	1,317	500
Cash at end of year	$ 6,793	$ 3,563	$ 1,317

NOTE 21 - QUARTERLY FINANCIAL DATA (UNAUDITED)

	Interest Income	Net Interest Income	Net Income	Earnings Per Share (1)	
				Basic	Fully Diluted
2018					
First quarter	$10,220	$ 8,794	$3,148	$ 0.53	$ 0.53
Second quarter	10,550	9,033	3,068	0.52	0.52
Third quarter	10,741	8,942	3,278	0.55	0.55
Fourth quarter	11,121	9,061	2,936	0.49	0.49
2017					
First quarter	$ 9,376	$ 8,178	$3,137	$ 0.53	$ 0.53
Second quarter	9,584	8,361	2,410	0.40	0.40
Third quarter	9,719	8,424	2,592	0.44	0.44
Fourth quarter	9,980	8,682	2,578	0.44	0.44

The Company recorded an additional $1.2 million in other income during the first quarter of 2017 for the sale of a building in Winchester, KY. After the associated income tax expense, this transaction increased net income by $789 thousand.

(1) See Note 1 in the notes to the consolidated financial statements for more detail on the stock split.

Item 9. Changes In and Disagreements with Accountants on Accounting and Financial Disclosure

None

Item 9A. Controls and Procedures

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Kentucky Bancshares' management is responsible for establishing and maintaining effective disclosure controls and procedures, as defined under Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. As of December 31, 2018, an evaluation was carried out by Kentucky Bancshares' management, with the participation of our Chief Executive Officer and our Chief Financial Officer of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, management concluded that disclosure controls and procedures as of December 31, 2018 were effective in ensuring material information required to be disclosed in this annual report on Form 10-K was recorded, processed, summarized, and reported on a timely basis.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There were no changes in Kentucky Bancshares' internal control over financial reporting that occurred during the year ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, Kentucky Bancshares internal control over financial reporting.

MANAGEMENT REPORT ON INTERNAL CONTROL

We, as management of Kentucky Bancshares, Inc. and its subsidiaries, are responsible for establishing and maintaining adequate internal control over financial reporting. Pursuant to the rules and regulations of the Securities and Exchange Commission, internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the Company; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

All internal control systems, no matter how well designed, have inherent limitations, including the possibility of human error and the circumvention of overriding controls. Accordingly, even effective internal control can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, the effectiveness of internal control may vary over time.

Because of the inherent limitations, any system of internal control over financial reporting, no matter how well designed, may not prevent or detect misstatements due to the possibility that a control can be circumvented or overridden or that misstatements due to error or fraud may occur that are not detected. Also, projections of the effectiveness to future periods are subject to the risk that the internal controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures included in such controls may deteriorate.

Management has evaluated the effectiveness of its internal control over financial reporting as of December 31, 2018 based on the control criteria in the 2013 COSO Framework issued by the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission. Based on such evaluation, we have concluded that Kentucky Bancshares' internal control over financial reporting is effective as of December 31, 2018.

The effectiveness of Kentucky Bancshares' internal control over financial reporting as of December 31, 2018 has been audited by Crowe, LLP, an independent registered public accounting firm that audited Kentucky Bancshares' consolidated financial statements included in this annual report.

Item 9B. Other Information

None

PART III

Item 10. Directors and Executive Officers and Corporate Governance

Set forth below is information about our executive officers who do not serve as Directors, including their business experience for at least the past five years and their ages as of March 15, 2019.

Name	Age	Position with the Company
James B. Braden	40	Executive Vice President, Chief Operations Officer. Previously Chief Administration Officer from 2013 to 2017 and Director of Risk Management from 2010 to 2012. Also, previously a Senior Manager at a national public accounting firm serving financial institutions.
Brenda S. Bragonier	62	Senior Vice President, Director of Marketing since 1999.
Carol Caskey	61	Senior Vice President, Director of Human Resources since 2011. Previously an Associate Relations Consultant at a national health insurance carrier.
Gregory J. Dawson	58	Senior Vice President, Chief Financial Officer since 1989.
James L. Elliott	72	Senior Vice President, Director of Wealth Management since 2013. Previously a Senior Vice President and Group Director of private financial services for a financial institution.
Shane Foley	42	Excecutive Vice President, Director of Retail Banking. Previously Vice President of Mortgage Lending from 2004 -2007 and Vice President of Commercial Lending from 2007-2019.
Norman J. Fryman	69	Executive Vice President, Chief Credit Officer since 2010. Director of Sales and Service from 2004 to 2009.
Christopher Gorley	48	Senior Vice President, Director of Operations since 2013. Previously a Vice President and Chief Operations Officer with a community bank.

The remaining information required by Item 10 is hereby incorporated by reference under the headings “Corporate Governance”, “Section 16(a) Beneficial Ownership Reporting Compliance” and “Proposal No. 2 — Election of Directors” from the Company’s definitive proxy statement in connection with its annual meeting of stockholders scheduled for May 21, 2019, which will be filed with the Commission on or about April 15, 2019, pursuant to Regulation 14A (“2018 Proxy Statement”).

Item 11. Executive Compensation

The information required by Item 11 is hereby incorporated by reference under the headings “Executive Compensation,” “Report of Compensation Committee” and “Compensation of Named Executive Officers” in the 2019 Proxy Statement.

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

The information required by Item 12 is hereby incorporated by reference under the heading “Stock Ownership of Directors and Executive Officers” in the 2019 Proxy Statement. See Part II, Item 5, for information about securities authorized for issuance under the Company’s equity compensation plans.

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

The information required by Item 13 is hereby incorporated by reference under the headings “Corporate Governance” and “Transactions with Related Persons” in the 2019 Proxy Statement.

Item 14. Principal Accountant Fees and Services

The information required by Item 14 is hereby incorporated by reference under the heading “Fees of Independent Registered Public Accounting Firm” in the 2019 Proxy Statement.

Part IV

Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a)(1) Financial Statements

The following financial statements are included in Item 8 of this Form 10-K.

Report of Independent Registered Public Accounting Firm
Consolidated Balance Sheets
Consolidated Statements of Income
Consolidated Statements of Comprehensive Income
Consolidated Statements of Changes in Stockholders' Equity
Consolidated Statements of Cash Flow
Notes to Consolidated Financial Statements

(a)(2) Financial Statement Schedules.

All financial statement schedules have been omitted as the required information is inapplicable or the required information has been included in the Consolidated Financial statements or notes thereto.

(a)(3) Exhibits

Reference is made to the Exhibit Index beginning on Page E-1 hereof.

Kentucky Bancshares, Inc.
Exhibit Index

2.1	Agreement and Plan of Merger with Peoples Bancorp of Sandy Hook is incorporated by reference to Exhibit 2.1 of the Registrant's Current Report on Form 8-K dated February 24, 2006.
2.2	Agreement and Plan of Share Exchange with Madison Financial Corporation is incorporated by reference to Exhibit 2.1 of the Registrant's Current Report on Form 8-K dated January 21, 2015.
3.1	Amended and Restated Articles of Incorporation of the Registrant are incorporated by reference to Exhibit 3.1 of the Registrant's Quarterly Report on Form 10-Q for the quarterly period ending March 31, 2000.
3.2	Bylaws of the Registrant are incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K dated November 21, 2007.
3.3	Articles of Amendment to Amended and Restated Articles of Incorporation of the Registrant are incorporated by reference to Exhibit 3.3 of the Registrant's Annual Report on Form 10-K for the period ending December 31, 2005 and filed March 29, 2006.
10.1	Kentucky Bancshares, Inc. 1993 Non-Employee Directors Stock Ownership Incentive Plan is incorporated by reference to Exhibit 10.3 of the Registrant's Registration Statement on Form S-4 (File No. 33-96358).
10.3	Employment Agreement for Louis Prichard as incorporated by reference to the Registrant's Current Report on Exhibit 10.1 of the Registrant's Current Report on Form 8-K dated April 3, 2008.
10.4	2005 Restricted Stock Grant Plan, including form of Award Agreement, as incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K dated February 22, 2005.
10.5	2009 Stock Award Plan, as incorporated by reference to Exhibit 10.1 of the Registrant's Quarterly Report on Form 10-Q for the quarterly period ending June 30, 2009.
11	Computation of earnings per share - See Note 13 in the notes to the consolidated financial statements included in Item 8.
21	Subsidiaries of Registrant
23	Consent of Crowe, LLP
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.

31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101 INS	XBRL Instance Document
101 SCH	XBRL Taxonomy Extension Scheme Document
101 CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101 DEF	XBRL Taxonomy Extension Definition Linkbase Document
101 LAB	XBRL Taxonomy Extension Label Linkbase Document
101 PRE	XBRL Taxonomy Extension Presentation Linkbase Document

SIGNATURES

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

Kentucky Bancshares, Inc.
By: /s/Louis Prichard
Louis Prichard, President and Chief Executive Officer, Director
March 15, 2019

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

/s/Louis Prichard Louis Prichard, President and Chief Executive Officer, Director	March 15, 2019
/s/Gregory J. Dawson Gregory J. Dawson, Chief Financial and Accounting Officer	March 15, 2019
/s/Buckner Woodford, IV Buckner Woodford, IV, Chairman of the Board, Director	March 15, 2019
/s/B. Proctor Caudill, Jr. B. Proctor Caudill, Jr., Director	March 15, 2019
/s/Henry Hinkle Henry Hinkle, Director	March 15, 2019
/s/Ted McClain Ted McClain, Director	March 15, 2019
/s/Jack W. Omohundro Jack W. Omohundro, Director	March 15, 2019
/s/Edwin S. Saunier Edwin S. Saunier, Director	March 15, 2019
/s/Robert G. Thompson Robert G. Thompson, Director	March 15, 2019
/s/ Woodford VanMeter Woodford Van Meter, Director	March 15, 2019

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Section 2: EX-21 (EX-21)

Exhibit 21

Subsidiaries of Registrant

Kentucky Bancshares, Inc.'s Subsidiaries

Kentucky Bank
KBI Insurance Company, Inc.

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Section 3: EX-23 (EX-23)

EXHIBIT 23

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements Nos. 333-92725, 333-130791 and 333-166780 on Form S-8 of Kentucky Bancshares, Inc. of our report dated March 15, 2019 relating to the consolidated financial statements and effectiveness of internal control over financial reporting, appearing in this Annual Report on Form 10-K.

/s/Crowe LLP
Crowe LLP

Washington, D.C.
March 15, 2019

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Section 4: EX-31.1 (EX-31.1)

Exhibit 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF SARBANES-OXLEY ACT

I, Louis Prichard, certify that:

1. I have reviewed this annual report on Form 10-K of Kentucky Bancshares, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal fourth quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: March 15, 2019

BY /s/ Louis Prichard
Louis Prichard
President & Chief Executive Officer

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Section 5: EX-31.2 (EX-31.2)

Exhibit 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF SARBANES-OXLEY ACT

I, Gregory J. Dawson, certify that:

1. I have reviewed this annual report on Form 10-K of Kentucky Bancshares, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal fourth quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: March 15, 2019

BY /s/ Gregory J. Dawson
Gregory J. Dawson
Chief Financial Officer

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Section 6: EX-32.1 (EX-32.1)

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Kentucky Bancshares, Inc. (the "Company") on Form 10-K for the period ended December 31, 2018 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Louis Prichard, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Louis Prichard
Chief Executive Officer

March 15, 2019

A signed original of this written statement required by Section 906 has been provided to Kentucky Bancshares, Inc. and will be retained by Kentucky Bancshares, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

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Section 7: EX-32.2 (EX-32.2)

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Kentucky Bancshares, Inc. (the “Company”) on Form 10-K for the period ended December 31, 2018 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Gregory J. Dawson, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Gregory J. Dawson
Chief Financial Officer

March 15, 2019

A signed original of this written statement required by Section 906 has been provided to Kentucky Bancshares, Inc. and will be retained by Kentucky Bancshares, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

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