HOME BANCSHARES INC
Form 10-Q
November 05, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Quarterly Period Ended September 30, 2015

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: 000-51904

HOME BANCSHARES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Arkansas **(State or other jurisdiction of** **incorporation or organization)**	**71-0682831** **(I.R.S. Employer** **Identification No.)**
719 Harkrider, Suite 100, Conway, Arkansas **(Address of principal executive offices)**	**72032** **(Zip Code)**

(501) 339-2929

(Registrant s telephone number, including area code)

Not Applicable

Former name, former address and former fiscal year, if changed since last report

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company ¨

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

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practical date.

Common Stock Issued and Outstanding: 70,106,620 shares as of October 30, 2015.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Some of our statements contained in this document, including matters discussed under the caption Management s Discussion and Analysis of Financial Condition and Results of Operation, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements relate to future events or our future financial performance and include statements about the competitiveness of the banking industry, potential regulatory obligations, our entrance and expansion into other markets, including through potential acquisitions, our other business strategies and other statements that are not historical facts. Forward-looking statements are not guarantees of performance or results. When we use words like may, plan, contemplate, anticipate, believe, intend, continue, expect, project, estimate, could, should, would, and similar expressions, you should consider them as identifying forward-looking statements, although we may use other phrasing. These forward-looking statements involve risks and uncertainties and are based on our beliefs and assumptions, and on the information available to us at the time that these disclosures were prepared. These forward-looking statements involve risks and uncertainties and may not be realized due to a variety of factors, including, but not limited to, the following:

- the effects of future economic conditions, including inflation or a decrease in commercial real estate and residential housing values;

- governmental monetary and fiscal policies, as well as legislative and regulatory changes;

- the impact of the Dodd-Frank financial regulatory reform act and regulations issued thereunder;

- the risks of changes in interest rates or the level and composition of deposits, loan demand and the values of loan collateral, securities and interest sensitive assets and liabilities;

- the effects of terrorism and efforts to combat it;

- credit risks;

- the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in our market area and elsewhere, including institutions operating regionally, nationally and internationally, together with competitors offering banking products and services by mail, telephone and the Internet;

- the effect of any mergers, acquisitions or other transactions to which we or our subsidiaries may from time to time be a party, including our ability to successfully integrate any businesses that we acquire;

- the failure of assumptions underlying the establishment of our allowance for loan losses; and

- the failure of assumptions underlying the estimates of the fair values for our covered assets, FDIC indemnification asset and FDIC claims receivable.

All written or oral forward-looking statements attributable to us are expressly qualified in their entirety by this Cautionary Note. Our actual results may differ significantly from those we discuss in these forward-looking statements. For other factors, risks and uncertainties that could cause our actual results to differ materially from estimates and projections contained in these forward-looking statements, see the Risk Factors section of our Form 10-K filed with the Securities and Exchange Commission (the SEC) on February 27, 2015 and our Form 10-Q filed with the SEC on August 6, 2015.

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PART I: FINANCIAL INFORMATION

Item 1: Financial Statements

Home BancShares, Inc.

Consolidated Balance Sheets

(In thousands, except share data)	September 30, 2015 (Unaudited)	December 31, 2014
Assets		
Cash and due from banks	$ 120,262	$ 105,438
Interest-bearing deposits with other banks	108,394	7,090
Cash and cash equivalents	228,656	112,528
Federal funds sold		250
Investment securities available-for-sale	1,141,405	1,067,287
Investment securities held-to-maturity	324,949	356,790
Loans receivable not covered by loss share	5,900,175	4,817,314
Loans receivable covered by FDIC loss share	105,414	240,188
Allowance for loan losses	(63,659)	(55,011)
Loans receivable, net	5,941,930	5,002,491
Bank premises and equipment, net	205,505	206,912
Foreclosed assets held for sale not covered by loss share	18,204	16,951
Foreclosed assets held for sale covered by FDIC loss share	2,612	7,871
FDIC indemnification asset	11,290	28,409
Cash value of life insurance	75,281	74,444
Accrued interest receivable	26,977	24,075
Deferred tax asset, net	63,075	65,227
Goodwill	322,728	325,423
Core deposit and other intangibles	18,828	20,925
Other assets	134,113	93,689
Total assets	$ 8,515,553	$ 7,403,272
Liabilities and Stockholders Equity		
Deposits:		
Demand and non-interest-bearing	$ 1,409,949	$ 1,203,306
Savings and interest-bearing transaction accounts	3,230,722	2,974,850
Time deposits	1,312,343	1,245,815
Total deposits	5,953,014	5,423,971
Securities sold under agreements to repurchase	134,142	176,465
FHLB borrowed funds	1,216,152	697,957
Accrued interest payable and other liabilities	60,141	28,761
Subordinated debentures	60,826	60,826

Total liabilities		7,424,275		6,387,980
Stockholders equity:				
Common stock, par value $0.01; shares authorized 100,000,000 in 2015 and 2014; shares issued and outstanding 68,000,363 in 2015 and 67,570,610 in 2014		680		676
Capital surplus		782,500		781,328
Retained earnings		299,984		226,279
Accumulated other comprehensive income		8,114		7,009
Total stockholders equity		1,091,278		1,015,292
Total liabilities and stockholders equity	$	8,515,553	$	7,403,272

See Condensed Notes to Consolidated Financial Statements.

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Home BancShares, Inc.

Consolidated Statements of Income

(In thousands, except per share data)	Three Months Ended September 30, 2015	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2015	Nine Months Ended September 30, 2014
	(Unaudited)			
Interest income:				
Loans	$ 88,671	$ 75,917	$ 246,518	$ 226,334
Investment securities				
Taxable	5,157	4,905	15,830	14,137
Tax-exempt	2,789	2,552	8,315	7,248
Deposits other banks	32	20	167	73
Federal funds sold	4	7	15	35
Total interest income	96,653	83,401	270,845	247,827
Interest expense:				
Interest on deposits	3,045	3,243	9,614	9,722
Federal funds purchased	1	2	3	2
FHLB borrowed funds	2,030	1,035	4,133	2,933
Securities sold under agreements to repurchase	146	186	481	536
Subordinated debentures	340	330	1,003	986
Total interest expense	5,562	4,796	15,234	14,179
Net interest income	91,091	78,605	255,611	233,648
Provision for loan losses	7,106	4,241	16,274	17,294
Net interest income after provision for loan losses	83,985	74,364	239,337	216,354
Non-interest income:				
Service charges on deposit accounts	6,250	6,275	17,724	18,379
Other service charges and fees	6,644	5,977	19,359	17,641
Trust fees	398	306	2,016	1,065
Mortgage lending income	3,132	1,901	8,019	5,215
Insurance commissions	548	984	1,755	3,334
Income from title services	28	59	98	162
Increase in cash value of life insurance	268	322	871	891
Dividends from FHLB, FRB, Bankers bank & other	433	389	1,267	1,206
Gain on acquisitions			1,635	
Gain on sale of SBA loans	151	183	151	183
Gain (loss) on sale of premises and equipment, net	(266)	(35)	(237)	419
Gain (loss) on OREO, net	(40)	529	190	1,927

Gain (loss) on securities, net			4	
FDIC indemnification accretion/(amortization), net	(1,994)	(6,947)	(8,152)	(18,313)
Other income	993	888	3,542	2,442
Total non-interest income	16,545	10,831	48,242	34,551
Non-interest expense:				
Salaries and employee benefits	22,225	19,368	63,671	57,114
Occupancy and equipment	6,540	6,234	19,267	18,711
Data processing expense	2,619	1,801	8,101	5,387
Other operating expenses	13,209	15,414	37,517	39,582
Total non-interest expense	44,593	42,817	128,556	120,794
Income before income taxes	55,937	42,378	159,023	130,111
Income tax expense	20,196	15,007	58,257	46,974
Net income	$ 35,741	$ 27,371	$ 100,766	$ 83,137
Basic earnings per share	$ 0.53	$ 0.41	$ 1.49	$ 1.27
Diluted earnings per share	$ 0.52	$ 0.41	$ 1.48	$ 1.26

See Condensed Notes to Consolidated Financial Statements.

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Home BancShares, Inc.

Consolidated Statements of Comprehensive Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	**2014**	**2015**	**2014**
(In thousands)	**(Unaudited)**			
Net income	$ 35,741	$ 27,371	$ 100,766	$ 83,137
Net unrealized (loss) gain on available-for-sale securities	3,670	1,071	1,823	15,594
Less: reclassification adjustment for realized (gains) losses included in income			(4)	
Other comprehensive (loss) income, before tax effect	3,670	1,071	1,819	15,594
Tax effect	(1,440)	(421)	(714)	(6,118)
Other comprehensive (loss) income	2,230	650	1,105	9,476
Comprehensive income	$ 37,971	$ 28,021	$ 101,871	$ 92,613

See Condensed Notes to Consolidated Financial Statements.

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Home BancShares, Inc.

Consolidated Statements of Stockholders Equity

Nine Months Ended September 30, 2015 and 2014

(In thousands, except share data)	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at January 1, 2014	$ 651	$ 708,058	$ 136,386	$ (4,140)	$ 840,955
Comprehensive income:					
Net income			83,137		83,137
Other comprehensive income (loss)				9,476	9,476
Net issuance of 43,698 shares of common stock from exercise of stock options	1	207			208
Issuance of 1,316,072 shares of common stock from acquisition of Traditions, net of issuance costs of approximately $215	13	39,254			39,267
Disgorgement of profits		25			25
Tax benefit from stock options exercised		410			410
Share-based compensation		1,619			1,619
Cash dividends Common Stock, $0.25 per share			(16,416)		(16,416)
Balances at September 30, 2014 (unaudited)	665	749,573	203,107	5,336	958,681
Comprehensive income:					
Net income			29,926		29,926
Other comprehensive income (loss)				1,673	1,673
Net issuance of 76,663 shares of common stock from exercise of stock options		366			366
Issuance of 1,020,824 shares of common stock from acquisition of Broward, net of issuance costs of approximately $116	10	30,121			30,131
Tax benefit from stock options exercised		815			815
Share-based compensation	1	453			454
Cash dividends - Common Stock, $0.10 per share			(6,754)		(6,754)
Balances at December 31, 2014	676	781,328	226,279	7,009	1,015,292
Comprehensive income:					
Net income			100,766		100,766
Other comprehensive income (loss)				1,105	1,105
Net issuance of 172,501 shares of common stock from exercise of stock options	2	211			213
Repurchase of 67,332 shares of common stock	(1)	(2,014)			(2,015)
Tax benefit from stock options exercised		196			196

Share-based compensation	3	2,779			2,782
Cash dividends Common Stock, $0.40 per share			(27,061)		(27,061)
Balances at September 30, 2015 (unaudited)	$ 680	$ 782,500	$ 299,984	$ 8,114	$ 1,091,278

See Condensed Notes to Consolidated Financial Statements.

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Home BancShares, Inc.

Consolidated Statements of Cash Flows

(In thousands)	Nine Months Ended September 30, 2015	Nine Months Ended September 30, 2014
	(Unaudited)	
Operating Activities		
Net income	$ 100,766	$ 83,137
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	7,728	7,492
Amortization/(accretion)	17,091	25,647
Share-based compensation	2,782	1,619
Tax benefits from stock options exercised	(196)	(410)
(Gain) loss on assets	(100)	(2,529)
Gain on acquisitions	(1,635)	
Provision for loan losses	16,274	17,294
Deferred income tax effect	1,438	15,752
Increase in cash value of life insurance	(871)	(891)
Originations of mortgage loans held for sale	(209,056)	(169,905)
Proceeds from sales of mortgage loans held for sale	199,797	163,228
Changes in assets and liabilities:		
Accrued interest receivable	(2,902)	289
Indemnification and other assets	(31,450)	26,959
Accrued interest payable and other liabilities	31,576	19,166
Net cash provided by (used in) operating activities	131,242	186,848
Investing Activities		
Net (increase) decrease in federal funds sold	250	(39,730)
Net (increase) decrease in loans, excluding loans acquired	(639,150)	(132,688)
Purchases of investment securities available-for-sale	(249,707)	(79,543)
Proceeds from maturities of investment securities available-for-sale	172,411	212,629
Proceeds from sale of investment securities available-for-sale	931	
Purchases of investment securities held-to-maturity	(6,562)	(194,240)
Proceeds from maturities of investment securities held-to-maturity	36,743	12,194
Proceeds from foreclosed assets held for sale	21,909	34,307
Proceeds from sale of SBA loans	2,160	1,488
Proceeds from sale of insurance book of business	2,938	
Purchases of premises and equipment, net	(6,558)	(3,680)
Return of investment on cash value of life insurance	27	
Net cash proceeds (paid) received market acquisitions	140,820	13,315
Net cash provided by (used in) investing activities	(523,788)	(175,948)

Financing Activities		
Net increase (decrease) in deposits, excluding deposits acquired	61,469	(383,123)
Net increase (decrease) in securities sold under agreements to repurchase	(42,323)	(89)
Net increase (decrease) in FHLB borrowed funds	518,195	360,249
Proceeds from exercise of stock options	213	208
Repurchase of common stock	(2,015)	
Disgorgement of profits		25
Common stock issuance costs market acquisitions		(215)
Tax benefits from stock options exercised	196	410
Dividends paid on common stock	(27,061)	(16,416)
Net cash provided by (used in) financing activities	508,674	(38,951)
Net change in cash and cash equivalents	116,128	(28,051)
Cash and cash equivalents beginning of year	112,528	165,534
Cash and cash equivalents end of period	$ 228,656	$ 137,483

See Condensed Notes to Consolidated Financial Statements.

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Home BancShares, Inc.

Condensed Notes to Consolidated Financial Statements

(Unaudited)

1. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Home BancShares, Inc. (the Company or HBI) is a bank holding company headquartered in Conway, Arkansas. The Company is primarily engaged in providing a full range of banking services to individual and corporate customers through its wholly-owned community bank subsidiary Centennial Bank (sometimes referred to as Centennial or the Bank). The Bank has branch locations in Arkansas, Florida and South Alabama and a loan production office in New York City. The Company is subject to competition from other financial institutions. The Company also is subject to the regulation of certain federal and state agencies and undergoes periodic examinations by those regulatory authorities.

A summary of the significant accounting policies of the Company follows:

Operating Segments

Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Bank is the only significant subsidiary upon which management makes decisions regarding how to allocate resources and assess performance. Each of the branches of the Bank provide a group of similar community banking services, including such products and services as commercial, real estate and consumer loans, time deposits, and checking and savings accounts. The individual bank branches have similar operating and economic characteristics. While the chief decision maker monitors the revenue streams of the various products, services and branch locations, operations are managed and financial performance is evaluated on a Company-wide basis. Accordingly, all of the community banking services and branch locations are considered by management to be aggregated into one reportable operating segment, community banking.

Use of Estimates

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.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, the valuation of investment securities, the valuation of foreclosed assets, the valuations of assets acquired and liabilities assumed in business combinations, covered loans and the related indemnification asset. In connection with the determination of the allowance for loan losses and the valuation of foreclosed assets, management obtains independent appraisals for significant properties.

Principles of Consolidation

The consolidated financial statements include the accounts of HBI and its subsidiaries. Significant intercompany accounts and transactions have been eliminated in consolidation.

Reclassifications

Various items within the accompanying consolidated financial statements for previous years have been reclassified to provide more comparative information. These reclassifications had no effect on net earnings or stockholders equity.

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Interim financial information

The accompanying unaudited consolidated financial statements as of September 30, 2015 and 2014 have been prepared in condensed format, and therefore do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

The information furnished in these interim statements reflects all adjustments, which are, in the opinion of management, necessary for a fair statement of the results for each respective period presented. Such adjustments are of a normal recurring nature. The results of operations in the interim statements are not necessarily indicative of the results that may be expected for any other quarter or for the full year. The interim financial information should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s 2014 Form 10-K, filed with the Securities and Exchange Commission.

Earnings per Share

Basic earnings per share is computed based on the weighted-average number of shares outstanding during each year. Diluted earnings per share is computed using the weighted-average shares and all potential dilutive shares outstanding during the period. The following table sets forth the computation of basic and diluted earnings per share (EPS) for the following periods:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2015	**2014**	**2015**	**2014**
	(In thousands)			
Net income	$ 35,741	$ 27,371	$ 100,766	$ 83,137
Average shares outstanding	67,869	66,223	67,698	65,499
Effect of common stock options	212	393	273	390
Average diluted shares outstanding	68,081	66,616	67,971	65,889
Basic earnings per share	$ 0.53	$ 0.41	$ 1.49	$ 1.27
Diluted earnings per share	$ 0.52	$ 0.41	$ 1.48	$ 1.26

2. Business Combinations

Acquisition of Pool of National Commercial Real Estate Loans

On April 1, 2015, the Company s wholly-owned bank subsidiary, Centennial, entered into an agreement with AM PR LLC, an affiliate of J.C. Flowers & Co. (collectively, the Seller) to purchase a pool of national commercial real estate loans totaling approximately $289.1 million for a purchase price of 99% of the total principal value of the acquired loans. The purchase of the loans was completed on April 1, 2015. The acquired loans were originated by the former Doral Bank within its Doral Property Finance portfolio (DPF Portfolio) and were transferred to the Seller by Banco Popular of Puerto Rico (Popular) upon its acquisition of the assets and liabilities of Doral Bank from the Federal Deposit Insurance Corporation (FDIC), as receiver for the failed Doral Bank. This pool of loans is now housed in a division of Centennial known as the Centennial Commercial Finance Group (Centennial CFG). The Centennial CFG is responsible for servicing the acquired loan pool and originating new loan production.

In connection with this acquisition of loans, the Company opened a loan production office on April 23, 2015 in New York City. Through the loan production office, Centennial CFG plans to build out a national lending platform focusing on commercial real estate plus commercial and industrial loans.

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Acquisition of Doral Bank s Florida Panhandle operations

On February 27, 2015, the Company s banking subsidiary, Centennial, acquired all the deposits and substantially all the assets of Doral Bank s Florida Panhandle operations (Doral Florida) through an alliance agreement with Popular who was the successful lead bidder with the FDIC on the failed Doral Bank of San Juan, Puerto Rico. Including the effects of the purchase accounting adjustments, the acquisition provided the Company with loans of approximately $37.9 million net of loan discounts, deposits of approximately $467.6 million, plus a $428.2 million cash settlement to balance the transaction. There is no loss-share with the FDIC in the acquired assets.

Prior to the acquisition, Doral Florida operated five branch locations in Panama City, Panama City Beach and Pensacola, Florida plus a loan production office in Tallahassee, Florida. At the time of acquisition, Centennial operated 29 branch locations in the Florida Panhandle. As a result, the Company closed all five branch locations during the July 2015 systems conversion and returned the facilities back to the FDIC.

The Company has determined that the acquisition of the net assets of Doral Florida constitutes a business combination as defined by the FASB ASC Topic 805, *Business Combinations*. Accordingly, the assets acquired and liabilities assumed are presented at their fair values as required. Fair values were determined based on the requirements of FASB ASC Topic 820, *Fair Value Measurements*. In many cases, the determination of these fair values required management to make estimates about discount rates, future expected cash flows, market conditions and other future events that are highly subjective in nature and subject to change. The following schedule is a breakdown of the assets acquired and liabilities assumed as of the acquisition date:

	Doral Bank s Florida Panhandle operations		
	Acquired from FDIC	**Fair Value Adjustments**	**As Recorded by HBI**
	(Dollars in thousands)		
Assets			
Cash and due from banks	$ 1,688	$ 428,214	$ 429,902
Loans receivable not covered by loss share	42,244	(4,300)	37,944
Total loans receivable	42,244	(4,300)	37,944
Core deposit intangible		1,363	1,363
Total assets acquired	$ 43,932	$ 425,277	$ 469,209
Liabilities			
Deposits			
Demand and non-interest-bearing	$ 3,130	$	$ 3,130
Savings and interest-bearing transaction accounts	119,865		119,865
Time deposits	343,271	1,308	344,579
Total deposits	466,266	1,308	467,574
Total liabilities assumed	$ 466,266	$ 1,308	$ 467,574

Pre-tax gain on acquisition	$	1,635

The following is a description of the methods used to determine the fair values of significant assets and liabilities presented above:

Cash and due from banks The carrying amount of these assets is a reasonable estimate of fair value based on the short-term nature of these assets. The $428.2 million adjustment is the cash settlement received from Popular for the net equity received, assets discount bid and other customary closing adjustments.

Loans Fair values for loans were based on a discounted cash flow methodology that considered factors including the type of loan and related collateral, classification status, fixed or variable interest rate, term of loan and whether or not the loan was amortizing, and current discount rates. The discount rates used for loans are based on current market rates for new originations of comparable loans and include adjustments for liquidity concerns.

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The Company evaluated $36.9 million of the loans purchased in conjunction with the acquisition in accordance with the provisions of FASB ASC Topic 310-20, *Nonrefundable Fees and Other Costs*, and were recorded with a $3.4 million discount. As a result, the fair value discount on these loans is being accreted into interest income over the weighted-average life of the loans using a constant yield method. The remaining approximately $5.3 million of loans evaluated were considered purchased credit impaired loans with in the provisions of FASB ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*, and were recorded with a $950,000 discount. These purchased credit impaired loans will recognize interest income through accretion of the difference between the carrying amount of the loans and the expected cash flows.

Core deposit intangible   This intangible asset represents the value of the relationships that Doral Florida had with its deposit customers. The fair value of this intangible asset was estimated based on a discounted cash flow methodology that gave appropriate consideration to expected customer attrition rates, cost of the deposit base, and the net maintenance cost attributable to customer deposits. The Company recorded $1.4 million of core deposit intangible.

Deposits   The fair values used for the demand and savings deposits that comprise the transaction accounts acquired, by definition, equal the amount payable on demand at the acquisition date. The Bank was able to reset deposit rates. However, the Bank did not lower the deposit rates as low as the market rates currently offered. As a result, a $1.3 million fair value adjustment was applied for time deposits because the estimated weighted-average interest rate of Doral Florida s certificates of deposits were still estimated to be above the current market rates after the rate reset.

The Company s operating results for the period ended September 30, 2015, include the operating results of the acquired assets and assumed liabilities subsequent to the acquisition date. Due to the fair value adjustments recorded and the fact Doral Florida total assets acquired excluding the cash settlement received is less than 1% of total assets as of acquisition date, historical results are not believed to be material to the Company s results, and thus no pro-forma information is presented.

Acquisition of Broward Financial Holdings, Inc.

On October 23, 2014, the Company completed its acquisition of Broward Financial Holdings, Inc. (Broward), parent company of Broward Bank of Commerce, pursuant to a previously announced definitive agreement and plan of merger whereby a wholly-owned acquisition subsidiary (Acquisition Sub II) of HBI merged with and into Broward, resulting in Broward becoming a wholly-owned subsidiary of HBI. Immediately thereafter, Broward Bank of Commerce was merged into Centennial. Under the terms of the Agreement and Plan of Merger dated July 30, 2014 by and among HBI, Centennial, Broward, Broward Bank of Commerce and Acquisition Sub II, HBI issued 1,020,824 shares of its common stock valued at approximately $30.2 million as of October 23, 2014, plus $3.3 million in cash in exchange for all outstanding shares of Broward common stock. HBI has also agreed to pay the Broward shareholders, at an undetermined date, up to approximately $751,000 in additional consideration. The amount and timing of the additional payment, if any, will depend on future payments received or losses incurred by Centennial from certain current Broward Bank of Commerce loans. At September 30, 2015 and December 31, 2014, the Company had recorded a fair value of zero for the potential additional consideration.

Prior to the acquisition, Broward Bank of Commerce operated two banking locations in Fort Lauderdale, Florida. Including the effects of the purchase accounting adjustments, Broward had approximately $184.4 million in total assets, $121.1 million in total loans after $3.0 million of loan discounts, and $134.2 million in deposits.

As of the acquisition date, Broward s common equity totaled $20.4 million and the Company paid a purchase price to the Broward shareholders of approximately $33.6 million for the Broward acquisition. As a result, the Company paid a multiple of 1.62 of Broward s book value per share and tangible book value per share.

See Note 2 Business Combinations in the Notes to Consolidated Financial Statements on Form 10-K for the year ended December 31, 2014 for an additional discussion regarding the acquisition of Broward.

Acquisition of Florida Traditions Bank

On July 17, 2014, the Company completed the acquisition of all of the issued and outstanding shares of common stock of Florida Traditions Bank (Traditions) and merged Traditions into Centennial. Under the terms of the

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Agreement and Plan of Merger dated April 25, 2014, by and among the Company, Centennial, and Traditions, the shareholders of Traditions received approximately $39.5 million of the Company s common stock valued at the time of closing, in exchange for all outstanding shares of Traditions common stock.

Prior to the acquisition, Traditions operated eight banking locations in Central Florida, including its main office in Dade City, Florida. Including the effects of the purchase accounting adjustments, Traditions had $310.5 million in total assets, $241.6 million in loans after $8.5 million of loan discounts, and $267.3 million in deposits.

The transaction was accretive to the Company s book value per common share and tangible book value per common share by $0.31 per share and $0.21 per share, respectively.

See Note 2 Business Combinations in the Notes to Consolidated Financial Statements on Form 10-K for the year ended December 31, 2014 for an additional discussion regarding the acquisition of Traditions.

3. Investment Securities

The amortized cost and estimated fair value of investment securities that are classified as available-for-sale and held-to-maturity are as follows:

	September 30, 2015			
	Available-for-Sale			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
	(In thousands)			
U.S. government-sponsored enterprises	$ 407,861	$ 3,375	$ (784)	$ 410,452
Mortgage-backed securities	480,457	5,736	(542)	485,651
State and political subdivisions	186,732	6,633	(180)	193,185
Other securities	53,003	210	(1,096)	52,117
Total	$ 1,128,053	$ 15,954	$ (2,602)	$ 1,141,405

	Held-to-Maturity			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
	(In thousands)			
U.S. government-sponsored enterprises	$ 7,760	$ 54	$ (28)	$ 7,786
Mortgage-backed securities	142,537	1,367	(74)	143,830
State and political subdivisions	174,652	4,090	(136)	178,606
Total	$ 324,949	$ 5,511	$ (238)	$ 330,222

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	December 31, 2014			
	Available-for-Sale			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
	(In thousands)			
U.S. government-sponsored enterprises	$ 333,880	$ 2,467	$ (269)	$ 336,078
Mortgage-backed securities	500,292	4,235	(1,445)	503,082
State and political subdivisions	170,207	6,522	(88)	176,641
Other securities	51,375	437	(326)	51,486
Total	$ 1,055,754	$ 13,661	$ (2,128)	$ 1,067,287

	Held-to-Maturity			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
	(In thousands)			
U.S. government-sponsored enterprises	$ 4,724	$ 2	$ (11)	$ 4,715
Mortgage-backed securities	161,051	580	(193)	161,438
State and political subdivisions	191,015	5,178	(74)	196,119
Total	$ 356,790	$ 5,760	$ (278)	$ 362,272

Assets, principally investment securities, having a carrying value of approximately $1.18 billion and $1.23 billion at September 30, 2015 and December 31, 2014, respectively, were pledged to secure public deposits and for other purposes required or permitted by law. Also, investment securities pledged as collateral for repurchase agreements totaled approximately $134.1 million and $176.5 million at September 30, 2015 and December 31, 2014, respectively.

The amortized cost and estimated fair value of securities classified as available-for-sale and held-to-maturity at September 30, 2015, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
	(In thousands)			
Due in one year or less	$ 324,213	$ 325,998	$ 71,087	$ 71,991
Due after one year through five years	639,384	648,881	186,329	190,339
Due after five years through ten years	123,420	123,869	27,081	27,438
Due after ten years	41,036	42,657	40,452	40,454

Total	$ 1,128,053	$ 1,141,405	$ 324,949	$ 330,222

For purposes of the maturity tables, mortgage-backed securities, which are not due at a single maturity date, have been allocated over maturity groupings based on anticipated maturities. The mortgage-backed securities may mature earlier than their weighted-average contractual maturities because of principal prepayments.

During the three-month period ended September 30, 2015, no available-for-sale securities were sold. During the nine-month period ended September 30, 2015, approximately $931,000, in available-for-sale securities were sold. The gross realized gain on the sale for the nine-month period ended September 30, 2015 totaled approximately $4,000. The income tax expense/benefit to net security gains and losses was 39.225% of the gross amounts.

During the three and nine-month periods ended September 30, 2014, no available-for-sale securities were sold.

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The Company evaluates all securities quarterly to determine if any unrealized losses are deemed to be other than temporary. In completing these evaluations the Company follows the requirements of FASB ASC 320, *Investments - Debt and Equity Securities.* Certain investment securities are valued less than their historical cost. These declines are primarily the result of the rate for these investments yielding less than current market rates. Based on evaluation of available evidence, management believes the declines in fair value for these securities are temporary. The Company does not intend to sell or believe it will be required to sell these investments before recovery of their amortized cost bases, which may be maturity. Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary impairment is identified.

During the nine-month period ended September 30, 2015, no securities were deemed to have other-than-temporary impairment besides securities for which impairment was taken in prior periods.

As of September 30, 2015, the Company had investment securities with a fair value of approximately $800,000 in unrealized losses, which have been in continuous loss positions for more than twelve months. Excluding impairment write downs taken in prior periods, the Company s assessments indicated that the cause of the market depreciation was primarily the change in interest rates and not the issuer s financial condition, or downgrades by rating agencies. In addition, approximately 84.0% of the Company s investment portfolio matures in five years or less. As a result, the Company has the ability and intent to hold such securities until maturity.

The following shows gross unrealized losses and estimated fair value of investment securities classified as available-for-sale and held-to-maturity with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual investment securities have been in a continuous loss position as of September 30, 2015 and December 31, 2014:

	September 30, 2015					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
U.S. government-sponsored enterprises	$ 96,280	$ (795)	$ 4,813	$ (17)	$ 101,093	$ (812)
Mortgage-backed securities	56,751	(336)	42,320	(280)	99,071	(616)
State and political subdivisions	38,235	(289)	3,217	(27)	41,452	(316)
Other securities	25,007	(620)	11,870	(476)	36,877	(1,096)
Total	$ 216,273	$ (2,040)	$ 62,220	$ (800)	$ 278,493	$ (2,840)

	December 31, 2014					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
U.S. government-sponsored enterprises	$ 22,004	$ (113)	$ 27,616	$ (167)	$ 49,620	$ (280)

Mortgage-backed securities	221,171	(812)	76,596	(826)	297,767	(1,638)
State and political subdivisions	15,171	(106)	10,038	(56)	25,209	(162)
Other securities	10,054	(51)	12,390	(275)	22,444	(326)
Total	$ 268,400	$ (1,082)	$ 126,640	$ (1,324)	$ 395,040	$ (2,406)

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Income earned on securities for the three and nine months ended September 30, 2015 and 2014, is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(In thousands)			
Taxable:				
Available-for-sale	$ 4,265	$ 4,295	$ 13,020	$ 13,214
Held-to-maturity	892	610	2,810	923
Non-taxable:				
Available-for-sale	1,457	1,391	4,178	4,330
Held-to-maturity	1,332	1,161	4,137	2,918
Total	$ 7,946	$ 7,457	$ 24,145	$ 21,385

4. Loans Receivable Not Covered by Loss Share

The various categories of loans not covered by loss share are summarized as follows:

	September 30, 2015	December 31, 2014
	(In thousands)	
Real estate:		
Commercial real estate loans		
Non-farm/non-residential	$ 2,655,882	$ 1,987,890
Construction/land development	805,003	700,139
Agricultural	75,233	72,211
Residential real estate loans		
Residential 1-4 family	1,055,504	963,990
Multifamily residential	392,483	250,222
Total real estate	4,984,105	3,974,452
Consumer	46,677	56,720
Commercial and industrial	749,846	670,124
Agricultural	78,217	48,833
Other	41,330	67,185
Loans receivable not covered by loss share	$ 5,900,175	$ 4,817,314

During the three and nine-month periods ended September 30, 2015, the Company sold $2.2 million of the guaranteed portion of SBA loans, which resulted in a gain of approximately $151,000. During the three and nine-month periods ended September 30, 2014, the Company sold $1.3 million of the guaranteed portion of SBA loans, which resulted in a gain of approximately $183,000.

Mortgage loans held for sale of approximately $39.4 million and $33.1 million at September 30, 2015 and December 31, 2014, respectively, are included in residential 1-4 family loans. Mortgage loans held for sale are carried at the lower of cost or fair value, determined using an aggregate basis. Gains and losses resulting from sales of mortgage loans are recognized when the respective loans are sold to investors. Gains and losses are determined by the difference between the selling price and the carrying amount of the loans sold, net of discounts collected or paid. The Company obtains forward commitments to sell mortgage loans to reduce market risk on mortgage loans in the process of origination and mortgage loans held for sale. The forward commitments acquired by the Company for mortgage loans in process of origination are not mandatory forward commitments. These commitments are structured on a best efforts basis; therefore the Company is not required to substitute another loan or to buy back the commitment if the original loan does not fund. Typically, the Company delivers the mortgage loans within a few days after the loans are funded. These commitments are derivative instruments and their fair values at September 30, 2015 and December 31, 2014 were not material.

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5. Loans Receivable Covered by FDIC Loss Share

The Company evaluated loans purchased in conjunction with the acquisitions under purchase and assumption agreements with the FDIC for impairment in accordance with the provisions of FASB ASC Topic 310-30. Purchased covered loans are considered impaired if there is evidence of credit deterioration since origination and if it is probable that not all contractually required payments will be collected.

The following table reflects the carrying value of all purchased FDIC covered impaired loans as of September 30, 2015 and December 31, 2014 for the Company:

	September 30, 2015	December 31, 2014
	(In thousands)	
Real estate:		
Commercial real estate loans		
Non-farm/non-residential	$ 25,903	$ 93,979
Construction/land development	7,836	39,946
Agricultural	735	943
Residential real estate loans		
Residential 1-4 family	66,447	87,309
Multifamily residential	1,200	8,617
Total real estate	102,121	230,794
Consumer	10	16
Commercial and industrial	2,682	8,651
Other	601	727
Loans receivable covered by FDIC loss share	$ 105,414	$ 240,188

The acquired loans were grouped into pools based on common risk characteristics and were recorded at their estimated fair values, which incorporated estimated credit losses at the acquisition dates. These loan pools are systematically reviewed by the Company to determine material changes in cash flow estimates from those identified at the time of the acquisition. Techniques used in determining risk of loss are similar to the Centennial non-covered loan portfolio, with most focus being placed on those loan pools which include the larger loan relationships and those loan pools which exhibit higher risk characteristics. As of September 30, 2015 and December 31, 2014, $5.2 million and $22.5 million, respectively, were accruing loans past due 90 days or more.

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6. Allowance for Loan Losses, Credit Quality and Other

The following table presents a summary of changes in the allowance for loan losses for the non-covered and covered loan portfolios for the nine months ended September 30, 2015:

	For Loans Not Covered by Loss Share	For Loans Covered by FDIC Loss Share	Total
		(In thousands)	
Allowance for loan losses:			
Beginning balance	$ 52,471	$ 2,540	$ 55,011
Loans charged off	(10,455)	(1,023)	(11,478)
Recoveries of loans previously charged off	2,260	133	2,393
Net loans recovered (charged off)	(8,195)	(890)	(9,085)
Provision for loan losses for non-covered loans	15,276		15,276
Reclass of provision for loan losses attributable to FDIC loss share agreements	1,029		1,029
Provision for loan losses forecasted outside of loss share			
Provision for loan losses before benefit attributable to FDIC loss share agreements		2,457	2,457
Change attributable to FDIC loss share agreements		(1,459)	(1,459)
Net provision for loan losses for covered loans		998	998
Reclass of provision for loan losses attributable to FDIC loss share agreements		(1,029)	(1,029)
Increase in FDIC indemnification asset		1,459	1,459
Balance, September 30, 2015	$ 60,581	$ 3,078	$ 63,659

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Allowance for Loan Losses and Credit Quality for Non-Covered Loans

The following tables present the balance in the allowance for loan losses for the non-covered loan portfolio for the three and nine-month periods ended September 30, 2015 and the allowance for loan losses and recorded investment in loans not covered by loss share based on portfolio segment by impairment method as of September 30, 2015. Allocation of a portion of the allowance to one type of loans does not preclude its availability to absorb losses in other categories. Additionally, the Company s discount for credit losses on non-covered loans acquired was $134.1 million, $139.7 million and $148.2 million at September 30, 2015, December 31, 2014 and September 30, 2014, respectively.

	Three Months Ended September 30, 2015						
	Construction/ Land Development	Other Commercial Real Estate	Residential Real Estate	Commercial & Industrial	Consumer & Other	Unallocated	Total
				(In thousands)			
Allowance for loan losses:							
Beginning balance	$ 9,403	$ 19,982	$ 12,934	$ 7,534	$ 5,011	$ 1,013	$ 55,877
Loans charged off	(64)	(1,534)	(1,043)	(355)	(970)		(3,966)
Recoveries of loans previously charged off	13	(4)	179	159	188		535
Net loans recovered (charged off)	(51)	(1,538)	(864)	(196)	(782)		(3,431)
Provision for loan losses	(805)	3,927	1,920	1,303	514	247	7,106
Reclass of provision for loan losses attributable to FDIC loss share agreements	745	1,033	(738)	(6)	(5)		1,029
Balance, September 30	$ 9,292	$ 23,404	$ 13,252	$ 8,635	$ 4,738	$ 1,260	$ 60,581

	Nine Months Ended September 30, 2015						
	Construction/ Land Development	Other Commercial Real Estate	Residential Real Estate	Commercial & Industrial	Consumer & Other	Unallocated	Total
				(In thousands)			
Allowance for loan losses:							
Beginning balance	$ 8,116	$ 17,227	$ 13,446	$ 5,950	$ 5,798	$ 1,934	$ 52,471
Loans charged off	(541)	(3,190)	(2,995)	(1,774)	(1,955)		(10,455)
Recoveries of loans previously charged off	79	697	428	395	661		2,260

Net loans recovered (charged off)	(462)	(2,493)	(2,567)	(1,379)	(1,294)		(8,195)
Provision for loan losses	893	7,637	3,111	4,070	239	(674)	15,276
Reclass of provision for loan losses attributable to FDIC loss share agreements	745	1,033	(738)	(6)	(5)		1,029
Balance, September 30	$ 9,292	$ 23,404	$ 13,252	$ 8,635	$ 4,738	$ 1,260	$ 60,581

	As of September 30, 2015						
	Construction/ Land Development	Other Commercial Real Estate	Residential Real Estate	Commercial & Industrial	Consumer & Other	Unallocated	Total
	(In thousands)						
Allowance for loan losses:							
Period end amount allocated to:							
Loans individually evaluated for impairment	$ 1,195	$ 2,036	$ 1,244	$ 988	$	$	$ 5,463
Loans collectively evaluated for impairment	8,096	21,200	11,963	7,646	4,737	1,260	54,902
Loans evaluated for impairment balance, September 30	9,291	23,236	13,207	8,634	4,737	1,260	60,365
Purchased credit impaired loans acquired	1	168	45	1	1		216
Balance, September 30	$ 9,292	$ 23,404	$ 13,252	$ 8,635	$ 4,738	$ 1,260	$ 60,581
Loans receivable:							
Period end amount allocated to:							
Loans individually evaluated for impairment	$ 21,247	$ 53,676	$ 18,240	$ 6,361	$ 7,202	$	$ 106,726
Loans collectively evaluated for impairment	767,683	2,581,800	1,378,584	730,753	157,664		5,616,484
Loans evaluated for impairment balance, September 30	788,930	2,635,476	1,396,824	737,114	164,866		5,723,210
Purchased credit impaired loans acquired	16,073	95,639	51,163	12,732	1,358		176,965
Balance, September 30	$ 805,003	$ 2,731,115	$ 1,447,987	$ 749,846	$ 166,224	$	$ 5,900,175

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The following tables present the balances in the allowance for loan losses for the non-covered loan portfolio for the nine-month period ended September 30, 2014 and the year ended December 31, 2014, and the allowance for loan losses and recorded investment in loans not covered by loss share based on portfolio segment by impairment method as of December 31, 2014. Allocation of a portion of the allowance to one type of loans does not preclude its availability to absorb losses in other categories.

	Year Ended December 31, 2014						
	Construction/ Land Development	Other Commercial Real Estate	Residential Real Estate	Commercial & Industrial	Consumer & Other	Unallocated	Total
	(In thousands)						
Allowance for loan losses:							
Beginning balance	$ 6,282	$ 15,100	$ 8,889	$ 1,933	$ 2,563	$ 4,255	$ 39,022
Loans charged off	(553)	(1,148)	(2,045)	(1,600)	(2,148)		(7,494)
Recoveries of loans previously charged off	68	230	385	255	935		1,873
Net loans recovered (charged off)	(485)	(918)	(1,660)	(1,345)	(1,213)		(5,621)
Provision for loan losses	733	4,117	5,160	2,763	3,965	556	17,294
Balance, September 30	6,530	18,299	12,389	3,351	5,315	4,811	50,695
Loans charged off	(420)	(1,174)	(1,004)	(566)	(647)		(3,811)
Recoveries of loans previously charged off	274	12	564	51	220		1,121
Net loans recovered (charged off)	(146)	(1,162)	(440)	(515)	(427)		(2,690)
Provision for loan losses	1,732	90	1,497	3,114	910	(2,877)	4,466
Balance, December 31	$ 8,116	$ 17,227	$ 13,446	$ 5,950	$ 5,798	$ 1,934	$ 52,471

	As of December 31, 2014						
	Construction/ Land Development	Other Commercial Real Estate	Residential Real Estate	Commercial & Industrial	Consumer & Other	Unallocated	Total
	(In thousands)						
Allowance for loan losses:							

Period end amount allocated to:							
Loans individually evaluated for impairment	$ 1,477	$ 3,080	$ 2,183	$ 6	$	$	$ 6,746
Loans collectively evaluated for impairment	6,624	12,447	10,827	5,880	5,798	1,934	43,510
Loans evaluated for impairment balance, December 31	8,101	15,527	13,010	5,886	5,798	1,934	50,256
Purchased credit impaired loans acquired	15	1,700	436	64			2,215
Balance, December 31	$ 8,116	$ 17,227	$ 13,446	$ 5,950	$ 5,798	$ 1,934	$ 52,471
Loans receivable:							
Period end amount allocated to:							
Loans individually evaluated for impairment	$ 19,037	$ 48,065	$ 21,734	$ 4,084	$ 484	$	$ 93,404
Loans collectively evaluated for impairment	659,465	1,900,472	1,131,021	650,163	169,815		4,510,936
Loans evaluated for impairment balance, December 31	678,502	1,948,537	1,152,755	654,247	170,299		4,604,340
Purchased credit impaired loans acquired	21,637	111,564	61,457	15,877	2,439		212,974
Balance, December 31	$ 700,139	$ 2,060,101	$ 1,214,212	$ 670,124	$ 172,738	$	$ 4,817,314

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The following is an aging analysis for the non-covered loan portfolio as of September 30, 2015 and December 31, 2014:

	September 30, 2015						
	Loans Past Due 30-59 Days	Loans Past Due 60-89 Days	Loans Past Due 90 Days or More	Total Past Due	Current Loans	Total Loans Receivable	Accruing Loans Past Due 90 Days or More
	(In thousands)						
Real estate:							
Commercial real estate loans							
Non-farm/non-residential	$ 2,080	$ 2,225	$ 19,685	$ 23,990	$ 2,631,892	$ 2,655,882	$ 2,694
Construction/land development	2,051	411	3,396	5,858	799,145	805,003	1,130
Agricultural	465		30	495	74,738	75,233	30
Residential real estate loans							
Residential 1-4 family	4,410	1,666	17,164	23,240	1,032,264	1,055,504	4,668
Multifamily residential			1,328	1,328	391,155	392,483	1
Total real estate	9,006	4,302	41,603	54,911	4,929,194	4,984,105	8,523
Consumer	298	76	210	584	46,093	46,677	7
Commercial and industrial	1,043	491	5,693	7,227	742,619	749,846	2,860
Agricultural and other	550	5	1,289	1,844	117,703	119,547	
Total	$ 10,897	$ 4,874	$ 48,795	$ 64,566	$ 5,835,609	$ 5,900,175	$ 11,390

	December 31, 2014						
	Loans Past Due 30-59 Days	Loans Past Due 60-89 Days	Loans Past Due 90 Days or More	Total Past Due	Current Loans	Total Loans Receivable	Accruing Loans Past Due 90 Days or More
	(In thousands)						
Real estate:							
Commercial real estate loans							
Non-farm/non-residential	$ 5,942	$ 1,311	$ 14,781	$ 22,034	$ 1,965,856	$ 1,987,890	$ 5,880
Construction/land development	2,696	847	1,660	5,203	694,936	700,139	734
Agricultural	307		34	341	71,870	72,211	34
Residential real estate loans							
Residential 1-4 family	4,680	1,494	16,077	22,251	941,739	963,990	4,128
Multifamily residential			2,035	2,035	248,187	250,222	691

Total real estate	13,625	3,652	34,587	51,864	3,922,588	3,974,452	11,467
Consumer	368	149	858	1,375	55,345	56,720	579
Commercial and industrial	1,669	549	3,933	6,151	663,973	670,124	2,825
Agricultural and other	463	16	184	663	115,355	116,018	
Total	$ 16,125	$ 4,366	$ 39,562	$ 60,053	$ 4,757,261	$ 4,817,314	$ 14,871

Non-accruing loans not covered by loss share at September 30, 2015 and December 31, 2014 were $37.4 million and $24.7 million, respectively.

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The following is a summary of the non-covered impaired loans as of September 30, 2015 and December 31, 2014:

	September 30, 2015						
				Three Months Ended		Nine Months Ended	
	Unpaid Contractual Principal Balance	Total Recorded Investment	Allocation of Allowance for Loan Losses	Average Recorded Investment	Interest Recognized	Average Recorded Investment	Interest Recognized
	(In thousands)						
Loans without a specific valuation allowance							
Real estate:							
Commercial real estate loans							
Non-farm/non-residential	$	$	$	$	$	$	$
Construction/land development							
Agricultural							
Residential real estate loans							
Residential 1-4 family				13		6	
Multifamily residential							
Total real estate				13		6	
Consumer							
Commercial and industrial							
Agricultural and other							
Total loans without a specific valuation allowance				13		6	
Loans with a specific valuation allowance							
Real estate:							
Commercial real estate loans							
Non-farm/non-residential	48,876	47,836	2,036	45,056	269	43,661	828
Construction/land development	13,807	12,987	1,195	13,113	44	16,263	214
Agricultural	53	30		30		51	
Residential real estate loans							
Residential 1-4 family	19,531	18,142	83	18,360	102	16,851	305
Multifamily residential	3,645	3,644	1,161	3,653	4	3,811	30
Total real estate	85,912	82,639	4,475	80,212	419	80,637	1,377
Consumer	217	211		415		640	6
Commercial and industrial	10,252	8,076	988	6,662	37	5,387	85
Agricultural and other	1,289	1,289		836		509	4
	97,670	92,215	5,463	88,125	456	87,173	1,472

Total loans with a specific valuation allowance							
Total impaired loans							
Real estate:							
Commercial real estate loans							
Non-farm/non-residential	48,876	47,836	2,036	45,056	269	43,661	828
Construction/land development	13,807	12,987	1,195	13,113	44	16,263	214
Agricultural	53	30		30		51	
Residential real estate loans							
Residential 1-4 family	19,531	18,142	83	18,373	102	16,857	305
Multifamily residential	3,645	3,644	1,161	3,653	4	3,811	30
Total real estate	85,912	82,639	4,475	80,225	419	80,643	1,377
Consumer	217	211		415		640	6
Commercial and industrial	10,252	8,076	988	6,662	37	5,387	85
Agricultural and other	1,289	1,289		836		509	4
Total impaired loans	$ 97,670	$ 92,215	$ 5,463	$ 88,138	$ 456	$ 87,179	$ 1,472

Note: Purchased non-covered loans acquired with deteriorated credit quality are accounted for on a pooled basis under ASC 310-30. All of these pools are currently considered to be performing resulting in none of the purchased non-covered loans acquired with deteriorated credit quality being classified as non-covered impaired loans as of September 30, 2015.

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	December 31, 2014			Year Ended	
	Unpaid Contractual Principal Balance	Total Recorded Investment	Allocation of Allowance for Loan Losses	Average Recorded Investment	Interest Recognized
			(In thousands)		
Loans without a specific valuation allowance					
Real estate:					
Commercial real estate loans					
Non-farm/non-residential	$	$	$	$ 676	$ 14
Construction/land development					
Agricultural					
Residential real estate loans					
Residential 1-4 family				25	2
Multifamily residential					
Total real estate				701	16
Consumer					
Commercial and industrial					
Agricultural and other					
Total loans without a specific valuation allowance				701	16
Loans with a specific valuation allowance					
Real estate:					
Commercial real estate loans					
Non-farm/non-residential	44,242	41,670	3,080	43,556	1,379
Construction/land development	18,369	18,075	1,477	21,142	656
Agricultural	53	33		60	1
Residential real estate loans					
Residential 1-4 family	18,052	16,051	1,065	16,701	407
Multifamily residential	4,614	4,327	1,118	4,037	120
Total real estate	85,330	80,156	6,740	85,496	2,563
Consumer	890	857		407	14
Commercial and industrial	5,916	4,246	6	5,059	151
Agricultural and other	185	185		114	
Total loans with a specific valuation allowance	92,321	85,444	6,746	91,076	2,728
Total impaired loans					
Real estate:					
Commercial real estate loans					
Non-farm/non-residential	44,242	41,670	3,080	44,232	1,393
Construction/land development	18,369	18,075	1,477	21,142	656
Agricultural	53	33		60	1
Residential real estate loans					
Residential 1-4 family	18,052	16,051	1,065	16,726	409
Multifamily residential	4,614	4,327	1,118	4,037	120

Total real estate	85,330	80,156	6,740	86,197	2,579
Consumer	890	857		407	14
Commercial and industrial	5,916	4,246	6	5,059	151
Agricultural and other	185	185		114	
Total impaired loans	$ 92,321	$ 85,444	$ 6,746	$ 91,777	$ 2,744

Note: Purchased non-covered loans acquired with deteriorated credit quality are accounted for on a pooled basis under ASC 310-30. All of these pools are currently considered to be performing resulting in none of the purchased non-covered loans acquired with deteriorated credit quality being classified as non-covered impaired loans as of December 31, 2014.

Interest recognized on non-covered impaired loans during the three months ended September 30, 2015 and 2014 was approximately $456,000 and $688,000, respectively. Interest recognized on non-covered impaired loans during the nine months ended September 30, 2015 and 2014 was approximately $1.5 million and $2.3 million, respectively. The amount of interest recognized on non-covered impaired loans on the cash basis is not materially different than the accrual basis.

Credit Quality Indicators. As part of the on-going monitoring of the credit quality of the Company s loan portfolio, management tracks certain credit quality indicators including trends related to (i) the risk rating of loans, (ii) the level of classified loans, (iii) net charge-offs, (iv) non-performing loans and (v) the general economic conditions in Florida, Arkansas and Alabama.

The Company utilizes a risk rating matrix to assign a risk rating to each of its loans. Loans are rated on a scale from 1 to 8. Descriptions of the general characteristics of the 8 risk ratings are as follows:

Risk rating 1 Excellent. Loans in this category are to persons or entities of unquestionable financial strength, a highly liquid financial position, with collateral that is liquid and well margined. These borrowers have performed without question on past obligations, and the Bank expects their performance to continue. Internally generated cash flow covers current maturities of long-term debt by a substantial margin. Loans secured by bank certificates of deposit and savings accounts, with appropriate holds placed on the accounts, are to be rated in this category.

Risk rating 2 Good. These are loans to persons or entities with strong financial condition and above-average liquidity that have previously satisfactorily handled their obligations with the Bank. Collateral securing the Bank s debt is margined in accordance with policy guidelines. Internally generated cash flow covers current maturities of long-term debt more than adequately. Unsecured loans to individuals supported by strong financial statements and on which repayment is satisfactory may be included in this classification.

Risk rating 3 Satisfactory. Loans to persons or entities with an average financial condition, adequate collateral margins, adequate cash flow to service long-term debt, and net worth comprised mainly of fixed assets are included in this category. These entities are minimally profitable now, with projections indicating continued profitability into the foreseeable future. Closely held corporations or businesses where a majority of the profits are withdrawn by the owners or paid in dividends are included in this rating category. Overall, these loans are basically sound.

Risk rating 4 Watch. Borrowers who have marginal cash flow, marginal profitability or have experienced an unprofitable year and a declining financial condition characterize these loans. The borrower has in the past satisfactorily handled debts with the Bank, but in recent months has either been late, delinquent in making payments, or made sporadic payments. While the Bank continues to be adequately secured, margins have decreased or are decreasing, despite the borrower s continued satisfactory condition. Other characteristics of borrowers in this class include inadequate credit information, weakness of financial statement and repayment capacity, but with collateral that appears to limit exposure. Included in this category are loans to borrowers in industries that are experiencing elevated risk.

Risk rating 5 Other Loans Especially Mentioned (OLEM). A loan criticized as OLEM has potential weaknesses that deserve management s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution s credit position at some future date. OLEM assets are not adversely classified and do not expose the institution to sufficient risk to warrant adverse classification.

Risk rating 6 Substandard. A loan classified as substandard is inadequately protected by the sound worth and paying capacity of the borrower or the collateral pledged. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual assets.

Risk rating 7 Doubtful. A loan classified as doubtful has all the weaknesses inherent in a loan 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. These are poor quality loans in which neither the collateral, if any, nor the financial condition of the borrower presently ensure collectability in full in a reasonable period of time; in fact, there is permanent impairment in the collateral securing the loan.

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Risk rating 8 Loss. Assets classified as loss are considered uncollectible and of such little value that the continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather, it is not practical or desirable to defer writing off this basically worthless asset, even though partial recovery may occur in the future. This classification is based upon current facts, not probabilities. Assets classified as loss should be charged-off in the period in which they became uncollectible.

The Company s classified loans include loans in risk ratings 6, 7 and 8. The following is a presentation of classified non-covered loans (excluding loans accounted for under ASC Topic 310-30) by class as of September 30, 2015 and December 31, 2014:

	September 30, 2015			
	Risk Rated 6	Risk Rated 7	Risk Rated 8	Classified Total
	(In thousands)			
Real estate:				
Commercial real estate loans				
Non-farm/non-residential	$ 38,335	$ 992	$	$ 39,327
Construction/land development	15,951			15,951
Agricultural				
Residential real estate loans				
Residential 1-4 family	14,538	728		15,266
Multifamily residential	3,679			3,679
Total real estate	72,503	1,720		74,223
Consumer	275	20		295
Commercial and industrial	4,579	26		4,605
Agricultural and other	1,194			1,194
Total	$ 78,551	$ 1,766	$	$ 80,317

	December 31, 2014			
	Risk Rated 6	Risk Rated 7	Risk Rated 8	Classified Total
	(In thousands)			
Real estate:				
Commercial real estate loans				
Non-farm/non-residential	$ 34,698	$ 24	$	$ 34,722
Construction/land development	16,112			16,112
Agricultural				
Residential real estate loans				
Residential 1-4 family	15,622	343		15,965
Multifamily residential	3,382			3,382
Total real estate	69,814	367		70,181
Consumer	903	19		922
Commercial and industrial	2,244	5		2,249

Agricultural and other	178			178
Total	$ 73,139	$ 391	$	$ 73,530

Loans may be classified, but not considered impaired, due to one of the following reasons: (1) The Company has established minimum dollar amount thresholds for loan impairment testing. All loans over $2.0 million that are rated 5 8 are individually assessed for impairment on a quarterly basis. Loans rated 5 8 that fall under the threshold amount are not individually tested for impairment and therefore are not included in impaired loans; (2) of the loans that are above the threshold amount and tested for impairment, after testing, some are considered to not be impaired and are not included in impaired loans.

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The following is a presentation of non-covered loans by class and risk rating as of September 30, 2015 and December 31, 2014:

	September 30, 2015						
	Risk Rated 1	Risk Rated 2	Risk Rated 3	Risk Rated 4 (In thousands)	Risk Rated 5	Classified Total	Total
Real estate:							
Commercial real estate loans							
Non-farm/non-residential	$ 497	$ 5,873	$ 1,798,471	$ 695,047	$ 21,543	$ 39,327	$ 2,560,758
Construction/land development	66	86	259,744	508,606	4,477	15,951	788,930
Agricultural		325	47,461	26,724	208		74,718
Residential real estate loans							
Residential 1-4 family	998	2,116	793,058	185,911	14,224	15,266	1,011,573
Multifamily residential		406	261,268	117,588	2,310	3,679	385,251
Total real estate	1,561	8,806	3,160,002	1,533,876	42,762	74,223	4,821,230
Consumer	13,967	273	20,750	10,424	124	295	45,833
Commercial and industrial	12,367	6,783	429,100	279,122	5,137	4,605	737,114
Agricultural and other	4,469	844	60,360	46,330	5,836	1,194	119,033
Total risk rated loans	$ 32,364	$ 16,706	$ 3,670,212	$ 1,869,752	$ 53,859	$ 80,317	5,723,210
Purchased credit impaired loans acquired							176,965
Total non-covered loans							$ 5,900,175

	December 31, 2014						
	Risk Rated 1	Risk Rated 2	Risk Rated 3	Risk Rated 4 (In thousands)	Risk Rated 5	Classified Total	Total
Real estate:							
Commercial real estate loans							
Non-farm/non-residential	$ 3,674	$ 15,914	$ 1,300,835	$ 501,931	$ 20,115	$ 34,722	$ 1,877,191
Construction/land development	15	355	241,659	415,380	4,981	16,112	678,502
Agricultural		610	35,539	34,469	728		71,346
Residential real estate loans							
Residential 1-4 family	494	3,505	714,278	165,464	11,730	15,965	911,436
Multifamily residential		400	192,687	42,578	2,272	3,382	241,319
Total real estate	4,183	20,784	2,484,998	1,159,822	39,826	70,181	3,779,794

Consumer	14,560	215	29,238	10,543	175	922	55,653
Commercial and industrial	13,081	16,957	430,026	189,318	2,616	2,249	654,247
Agricultural and other	573	790	87,347	25,237	521	178	114,646
Total risk rated loans	$ 32,397	$ 38,746	$ 3,031,609	$ 1,384,920	$ 43,138	$ 73,530	4,604,340
Purchased credit impaired loans acquired							212,974
Total non-covered loans							$ 4,817,314

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The following is a presentation of non-covered troubled debt restructurings (TDRs) by class as of September 30, 2015 and December 31, 2014:

	September 30, 2015					
	Number of Loans	Pre-Modification Outstanding Balance	Rate Modification	Term Modification	Rate & Term Modification	Post-Modification Outstanding Balance
	(Dollars in thousands)					
Real estate:						
Commercial real estate loans						
Non-farm/non-residential	14	$ 23,075	$ 8,939	$ 8,806	$ 4,649	$ 22,394
Construction/land development	3	3,040	1,018	1,612		2,630
Residential real estate loans						
Residential 1-4 family	6	2,867	813	1,818	165	2,796
Multifamily residential	2	3,182	2,027		290	2,317
Total real estate	25	32,164	12,797	12,236	5,104	30,137
Total	25	$ 32,164	$ 12,797	$ 12,236	$ 5,104	$ 30,137

	December 31, 2014					
	Number of Loans	Pre-Modification Outstanding Balance	Rate Modification	Term Modification	Rate & Term Modification	Post-Modification Outstanding Balance
	(Dollars in thousands)					
Real estate:						
Commercial real estate loans						
Non-farm/non-residential	7	$ 17,340	$ 2,596	$ 8,647	$ 5,644	$ 16,887
Construction/land development	2	8,213	5,671	1,668		7,339
Residential real estate loans						
Residential 1-4 family	1	61		58		58
Multifamily residential	2	3,183	2,002		291	2,293
Total real estate	12	2018	2017	2018	2017	

Service cost	$ 152	$ 154	$ 5	$ 5
Interest cost	650	565	5	5
Amortization of prior service credit	(25)	(41)	—	—
Amortization of net actuarial (gain) loss	296	205	(5)	(4)
Total benefit cost	$ 1,073	$ 883	$ 5	$ 6

U.S. International

Six Months Ended	2018	2017	2018	2017
Service cost	$373	$ 376	$10	$ 9
Interest cost	1,278	1,152	10	10
Amortization of prior service credit	(50)	(82)	—	—
Amortization of net actuarial (gain) loss	545	434	(10)	(8)
Total benefit cost	$2,146	$ 1,880	$10	$ 11

7. Income taxes

We record our interim provision for income taxes based on our estimated annual effective tax rate, as well as certain items discrete to the current period. The effective tax rates for the three and six months ended April 30, 2018 were 22.8% and 11.7%, respectively. The effective tax rates for the three and six months ended April 30, 2017 were 31.8% and 30.6%, respectively. The effective tax rate for the current quarter was lower than the comparable prior year period primarily due to recently enacted law commonly referred to as the U.S. Tax Cuts and Jobs Act ("the Act") as set forth below.

The Act was enacted into law on December 22, 2017. It reduces the U.S. federal corporate income tax rate from 35% to 21%. We have an October 31 fiscal year-end, therefore the lower corporate income tax rate will be phased in, resulting in a U.S. statutory federal rate of 23.3% for our fiscal year ending October 31, 2018, and 21% for subsequent fiscal years. The statutory tax rate of 23.3% was applied to earnings in the current quarter.

The Act requires us to revalue our existing U.S. deferred tax balance to reflect the lower statutory tax rate and pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously deferred from U.S. taxes. As a result, during the first quarter of 2018, we recorded a provisional tax benefit of $45,213 to reflect the revaluation of our tax assets and liabilities at the reduced corporate tax rate. We also recorded a provisional tax expense of $23,124 to reflect the transition tax on previously deferred foreign earnings. The net tax effect of these discrete items resulted in a decrease of $22,089 in income tax expense for the six months ended April 30, 2018. We intend to pay the transition tax in installments over the eight year period allowable under the Act. The transition tax is primarily included in other long-term liabilities in the Consolidated Balance Sheet at April 30, 2018. The amounts recorded are considered a provisional estimate under the U.S. Securities and Exchange Commission Staff Accounting Bulletin No. 118. The provisional calculations may change after the underlying temporary differences and foreign earnings are finalized. Furthermore, we are still analyzing certain aspects of the Act and related interpretive guidance and refining our calculations which could potentially affect the measurement of these balances or potentially give rise to new or additional deferred tax amounts.

In March 2016, the FASB issued a new standard which simplifies the accounting for share-based payment transactions, which we adopted in the first quarter of 2018. This guidance requires that excess tax benefits and tax deficiencies be recognized as income tax expense or benefit in the Consolidated Statements of Income rather than as additional paid-in capital. As a result, our income tax provision for the three and six months ended April 30, 2018 includes a discrete tax benefit of $2,202 and $6,950, respectively.

During the three months ended April 30, 2017, we recorded a discrete tax expense of $2,600 related to nondeductible acquisition costs.

8. Accumulated other comprehensive loss

The components of accumulated other comprehensive loss, including adjustments for items that are reclassified from accumulated other comprehensive loss to net income, are shown below.

	Cumulative translation adjustments	Pension and postretirement benefit plan adjustments	Accumulated other comprehensive loss
Balance at October 31, 2017	$ (28,423)	$ (106,012)	$ (134,435)
Pension and postretirement plan changes, net of tax of $(1,334)	—	4,321	4,321
Currency translation losses	19,298	—	19,298
Balance at April 30, 2018	$ (9,125)	$ (101,691)	$ (110,816)

9. Stock-based compensation

During the 2018 Annual Meeting of Shareholders, our shareholders approved the Amended and Restated 2012 Stock Incentive and Award Plan (the “2012 Plan”). The 2012 Plan provides for the granting of stock options, stock appreciation rights, restricted shares, restricted share units, performance shares, cash awards and other stock or performance-based incentives. A maximum of 4,525 common shares is available for grant under the 2012 Plan.

Stock Options

Nonqualified or incentive stock options may be granted to our employees and directors. Generally, options granted to employees may be exercised beginning one year from the date of grant at a rate not exceeding 25 percent per year and expire 10 years from the date of grant. Vesting accelerates upon a qualified termination in connection with a change in control. In the event of termination of employment due to early retirement or normal retirement at age 65, options granted within 12 months prior to termination are forfeited, and vesting continues post retirement for all other unvested options granted. In the event of disability or death, all unvested stock options granted within 12 months prior to termination (or at any time prior to December 28, 2017) fully vest. Termination for any other reason results in forfeiture of unvested options and vested options in certain circumstances. The amortized cost of options is accelerated if the retirement eligibility date occurs before the normal vesting date. Option exercises are satisfied through the issuance of treasury shares on a first-in, first-out basis. We recognized compensation expense related to stock options of $2,454 and $2,312 in the three months ended April 30, 2018 and 2017, respectively. Corresponding amounts for the six months ended April 30, 2018 and 2017 were $5,071 and $4,634, respectively.

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The following table summarizes activity related to stock options for the six months ended April 30, 2018:

	Number of Options	Weighted-Average Exercise Price Per Share	Aggregate Intrinsic Value	Weighted Average Remaining Term
Outstanding at October 31, 2017	1,922	$ 70.08		
Granted	368	$ 127.67		
Exercised	(319)	$ 48.94		
Forfeited or expired	(5)	$ 95.48		
Outstanding at April 30, 2018	1,966	$ 84.21	$ 87,282	6.9 years
Vested or expected to vest at April 30, 2018	1,944	$ 83.83	$ 87,036	6.9 years
Exercisable at April 30, 2018	1,023	$ 65.54	$ 64,539	5.4 years

As of April 30, 2018, there was $12,874 of total unrecognized compensation cost related to unvested stock options. That cost is expected to be amortized over a weighted average period of approximately 1.5 years.

The fair value of each option grant was estimated at the date of grant using the Black-Scholes option-pricing model with the following assumptions:

Six months ended	April 30, 2018	April 30, 2017
Expected volatility	24.0%-26.7%	26.0%-29.2%
Expected dividend yield	0.97%	0.91%-1.17%
Risk-free interest rate	2.09%-2.20%	1.89%-2.06%
Expected life of the option (in years)	5.4-6.2	5.4-6.2

The weighted-average expected volatility used to value the 2018 and 2017 options was 25.0% and 29.1%, respectively.

Historical information was the primary basis for the selection of the expected volatility, expected dividend yield and the expected lives of the options. The risk-free interest rate was selected based upon yields of U.S. Treasury issues with a term equal to the expected life of the option being valued.

The weighted average grant date fair value of stock options granted during the six months ended April 30, 2018 and 2017 was $31.42 and $28.86, respectively.

The total intrinsic value of options exercised during the three months ended April 30, 2018 and 2017 was $11,021 and $6,806, respectively. The total intrinsic value of options exercised during the six months ended April 30, 2018 and

2017 was $29,744 and $19,256, respectively.

Cash received from the exercise of stock options for the six months ended April 30, 2018 and 2017 was $15,595 and $12,040, respectively.

Restricted Shares and Restricted Share Units

We may grant restricted shares and/or restricted share units to our employees and directors. These shares or units may not be transferred for a designated period of time (generally one to three years) defined at the date of grant.

For employee recipients, in the event of termination of employment due to early retirement with the consent of the Company, restricted shares granted within 12 months prior to termination are forfeited, and other restricted shares vest on a pro-rata basis. In the event of termination of employment due to normal retirement at age 65, restricted shares granted within 12 months prior to termination are forfeited, and, for other restricted shares, the restriction period will lapse and the shares will vest and be transferable. For restricted shares granted within 12 months prior to termination (or at any time prior to December 28, 2017), the restrictions lapse in the event of a recipient's disability or death. Termination for any other reason prior to the lapse of any restrictions results in forfeiture of the shares.

For non-employee directors, all restrictions lapse in the event of disability or death of the non-employee director. Termination of service as a director for any other reason within one year of date of grant results in a pro-rata vesting of shares or units.

As shares or units are issued, deferred stock-based compensation equivalent to the fair value on the date of grant is expensed over the vesting period. Tax benefits arising from the lapse of restrictions are recognized when realized and credited to capital in excess of stated value.

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The following table summarizes activity related to restricted shares during the six months ended April 30, 2018:

	Number of Shares	Weighted-Average Grant Date Fair Value
Restricted shares at October 31, 2017	58	$ 90.38
Granted	20	$ 127.68
Vested	(23)	$ 84.78
Restricted shares at April 30, 2018	55	$ 106.33

As of April 30, 2018, there was $4,058 of unrecognized compensation cost related to restricted shares. The cost is expected to be amortized over a weighted average period of 2.0 years. The amount charged to expense related to restricted shares during the three months ended April 30, 2018 and 2017 was $637 and $510, respectively. These amounts included common share dividends for the three months ended April 30, 2018 and 2017 of $17 and $15, respectively. For the six months ended April 30, 2018 and 2017, the amounts charged to expense related to restricted shares were $1,391 and $1,088, respectively. These amounts included common share dividends for the six months ended April 30, 2018 and 2017 of $34 and $31, respectively.

The following table summarizes activity related to restricted share units during the six months ended April 30, 2018:

	Number of Units	Weighted-Average Grant Date Fair Value
Restricted share units at October 31, 2017	0	$ —
Granted	8	$ 126.38
Restricted share units at April 30, 2018	8	$ 126.38

As of April 30, 2018, there was $500 of remaining expense to be recognized related to outstanding restricted share units, which is expected to be recognized over a weighted average period of 0.5 years. The amount charged to expense related to restricted share units during each of the three months ended April 30, 2018 and 2017 was $252 and $253, respectively. For the six months ended April 30, 2018 and 2017, the corresponding amounts were $505 and $506, respectively.

Deferred Directors' Compensation

Non-employee directors may defer all or part of their cash and equity-based compensation until retirement. Cash compensation may be deferred as cash or as share equivalent units. Deferred cash amounts are recorded as liabilities, and share equivalent units are recorded as equity. Additional share equivalent units are earned when common share dividends are declared.

The following table summarizes activity related to director deferred compensation share equivalent units during the six months ended April 30, 2018:

	Number of Shares	Weighted-Average Grant Date Fair Value
Outstanding at October 31, 2017	101	$ 46.74
Dividend equivalents	1	$ 141.77
Outstanding at April 30, 2018	102	$ 47.14

The amount charged to expense related to director deferred compensation for the three months ended April 30, 2018 and 2017 was $30 and $26, respectively. For the six months ended April 30, 2018 and 2017, the corresponding amounts were $61 and $52, respectively.

Performance Share Incentive Awards

Executive officers and selected other key employees are eligible to receive common share-based incentive awards. Payouts, in the form of unrestricted common shares, vary based on the degree to which corporate financial performance exceeds predetermined threshold, target and maximum performance goals over three-year performance periods. No payout will occur unless threshold performance is achieved.

The amount of compensation expense is based upon current performance projections for each three-year period and the percentage of the requisite service that has been rendered. The calculations are also based upon the grant date fair value determined using the closing market price of our common shares at the grant date, reduced by the implied value of dividends not to be paid. The per share values were $123.45 for 2018, $103.75 and $104.49 per share for 2017 and $67.69 per share for 2016. During the three months ended April 30, 2018 and 2017, $1,637 and $3,178 was charged to expense, respectively. For the six months ended April 30, 2018 and 2017, the corresponding amounts were $4,986 and $3,430, respectively. The cumulative amount recorded in shareholders' equity at April 30, 2018 was $12,108.

Deferred Compensation

Our executive officers and other highly compensated employees may elect to defer up to 100% of their base pay and cash incentive and for executive officers, up to 90% of their share-based performance incentive payout each year. Additional share units are credited for quarterly dividends paid our common shares. Expense related to dividends paid under this plan for the three months ended April 30, 2018 and 2017 was $67 and $68, respectively. For the six months ended April 30, 2018 and 2017, the corresponding amounts were $134 and $129, respectively.

10. Warranties

We offer warranties to our customers depending on the specific product and terms of the customer purchase agreement. A typical warranty program requires that we repair or replace defective products within a specified time period (generally one year) from the date of delivery or first use. We record an estimate for future warranty-related costs based on actual historical return rates. Based on analysis of return rates and other factors, the adequacy of our warranty provisions are adjusted as necessary. The liability for warranty costs is included in accrued liabilities in the Consolidated Balance Sheet.

Following is a reconciliation of the product warranty liability for the six months ended April 30, 2018 and 2017:

	April 30, 2018	April 30, 2017
Beginning balance at October 31	$13,377	$11,770
Accruals for warranties	5,937	5,148
Warranty assumed from acquisitions	-	61
Warranty payments	(6,642)	(4,821)
Currency effect	227	2
Ending balance	$12,899	$12,160

11. Operating segments

We conduct business across three primary business segments: Adhesive Dispensing Systems, Advanced Technology Systems, and Industrial Coating Systems. The composition of segments and measure of segment profitability is consistent with that used by our chief operating decision maker. The primary measure used by the chief operating decision maker for purposes of making decisions about allocating resources to the segments and assessing performance is operating profit, which equals sales less cost of sales and certain operating expenses. Items below the operating profit line of the Consolidated Statement of Income (interest and investment income, interest expense and other income/expense) are excluded from the measure of segment profitability reviewed by our chief operating decision maker and are not presented by operating segment. The accounting policies of the segments are the same as those described in Note 1, Significant Accounting Policies, of our annual report on Form 10-K for the year ended October 31, 2017.

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The following table presents information about our segments:

	Adhesive Dispensing Systems		Advanced Technology Systems	Industrial Coating Systems	Corporate	Total
Three months ended						
April 30, 2018						
Net external sales	$ 238,775		$ 250,839	$ 64,092	$ —	$ 553,706
Operating profit (loss)	69,514	(a)	58,306	11,572	(12,687)	126,705
Three months ended						
April 30, 2017						
Net external sales	$ 226,943		$ 210,142	$ 59,052	$ —	$ 496,137
Operating profit (loss)	65,719	(b)	54,306	10,252	(26,746)	103,531
Six months ended						
April 30, 2018						
Net external sales	$ 459,639		$ 522,540	$ 121,951	$ —	$ 1,104,130
Operating profit (loss)	122,829	(a)	125,574	21,732	(25,707)	244,428
Six months ended						
April 30, 2017						
Net external sales	$ 434,780		$ 355,502	$ 113,325	$ —	$ 903,607
Operating profit (loss)	118,775	(b)	80,669	17,337	(37,332)	179,449

(a) Includes $1,082 and $2,149 of severance and restructuring costs in the three and six months ended April 30, 2018, respectively.

(b) Includes $491 and $718 of severance and restructuring costs in the three and six months ended April 30, 2017, respectively.

A reconciliation of total segment operating income to total consolidated income before income taxes is as follows:

	Three Months Ended		Six Months Ended	
	April 30, 2018	April 30, 2017	April 30, 2018	April 30, 2017
Total profit for reportable segments	$ 126,705	$ 103,531	$ 244,428	$ 179,449
Interest expense	(12,127)	(7,907)	(23,445)	(13,548)
Interest and investment income	219	272	509	545
Other-net	3,322	(1,323)	145	(1,480)
Income before income taxes	$ 118,119	$ 94,573	$ 221,637	$ 164,966

We have significant sales in the following geographic regions:

	Three Months Ended		Six Months Ended	
	April 30, 2018	April 30, 2017	April 30, 2018	April 30, 2017
United States	$178,821	$156,095	$344,652	$281,616
Americas	38,959	36,326	73,238	66,368
Europe	154,736	128,468	296,674	247,627
Japan	33,030	30,855	98,899	55,032
Asia Pacific	148,160	144,393	290,667	252,964
Total net external sales	$553,706	$496,137	$1,104,130	$903,607

12. Fair value measurements

The inputs to the valuation techniques used to measure fair value are classified into the following categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

The following table presents the classification of our assets and liabilities measured at fair value on a recurring basis at April 30, 2018:

	Total	Level 1	Level 2	Level 3
Assets:				
Foreign currency forward contracts (a)	3,213	—	3,213	—
Total assets at fair value	$3,213	$ —	$3,213	$ —
Liabilities:				
Deferred compensation plans (b)	$11,796	$ —	$11,796	$ —
Foreign currency forward contracts (a)	5,494	—	5,494	—
Total liabilities at fair value	$17,290	$ —	$17,290	$ —

(a) We enter into foreign currency forward contracts to reduce the risk of foreign currency exposures resulting from receivables, payables, intercompany receivables, intercompany payables and loans denominated in foreign currencies. Foreign currency forward contracts are valued using market exchange rates. Foreign currency forward contracts are not designated as hedges. Foreign currency forward contracts in an asset position are classified in Receivables-net and foreign currency forward contracts in a liability position are classified in Accrued liabilities on the Consolidated Balance Sheets.

(b) Executive officers and other highly compensated employees may defer up to 100% of their salary and annual cash incentive award and for executive officers, up to 90% of their long-term performance share incentive award, into various non-qualified deferred compensation plans. Deferrals can be allocated to various market performance measurement funds. Changes in the value of compensation deferred under these plans are recognized each period based on the fair value of the underlying measurement funds.

13. Financial instruments

We operate internationally and enter into intercompany transactions denominated in foreign currencies. Consequently, we are subject to market risk arising from exchange rate movements between the dates foreign currencies are recorded and the dates they are settled. We regularly use foreign currency forward contracts to reduce our risks related to most of these transactions. These contracts usually have maturities of 90 days or less and generally require us to exchange foreign currencies for U.S. dollars at maturity, at rates stated in the contracts. These contracts are not designated as hedging instruments. We do not use financial instruments for trading or speculative purposes.

Gains and losses on foreign currency forward contracts are recorded in “Other – net” on the Consolidated Statement of Income together with the transaction gain or loss from the hedged balance sheet position. For the three months ended April 30, 2018, we recognized losses of $1,607 on foreign currency forward contracts and gains of $2,584 from the change in fair value of balance sheet positions. For the three months ended April 30, 2017, we recognized losses of $1,687 on foreign currency forward contracts and gains of $702 from the change in fair value of balance sheet positions. For the six months ended April 30, 2018, we recognized losses of $2,571 on foreign currency forward contracts and gains of $1,602 from the change in fair value of balance sheet positions. For the six months ended April

30, 2017, we recognized losses of $1,900 on foreign currency forward contracts and gains of $906 from the change in fair value of balance sheet positions.

The following table summarizes, by currency, the foreign currency forward contracts outstanding at April 30, 2018:

	Sell Notional Amounts	Fair Value	Buy Notional Amounts	Fair Value
Euro	$152,436	$149,658	$82,687	$80,189
British pound	43,914	42,617	58,981	57,370
Japanese yen	32,610	31,785	35,260	34,116
Australian dollar	194	188	8,137	7,774
Hong Kong dollar	2,170	2,166	110,723	111,005
Singapore dollar	616	608	13,143	12,967
Others	4,398	4,191	52,468	50,573
Total	$236,338	$231,213	$361,399	$353,994

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The carrying amounts and fair values of financial instruments at April 30, 2018, other than cash and cash equivalents, receivables and accounts payable, are shown in the table below. The carrying values of cash and cash equivalents, receivables and accounts payable approximate fair value due to the short-term nature of these instruments.

	Carrying Amount	Fair Value
Long-term debt, including current maturities	$1,539,046	$1,529,148
Foreign currency forward contracts (net)	(2,281)	(2,281)

We used the following methods and assumptions in estimating the fair value of financial instruments:

- Long-term debt is valued by discounting future cash flows at currently available rates for borrowing arrangements with similar terms and conditions, which are considered to be Level 2 inputs under the fair value hierarchy.
- Foreign currency forward contracts are valued using observable market based inputs, which are considered to be Level 2 inputs under the fair value hierarchy.

14. Subsequent events

On May 17, 2018, we entered into a Second Amendment to our $705,000 Term Loan Agreement with the lenders party thereto, and PNC Bank, as administrative agent, to extend the maturity due date of the $200,000 tranche from September 30, 2018 to September 30, 2021. As of April 30, 2018, this $200,000 tranche is presented as Current maturities of long-term debt in our Consolidated Balance Sheets and will be reclassified to Long-term debt in the third quarter of 2018. All other terms governing this term loan facility remain substantially the same.

ITEM 2.MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is Management's discussion and analysis of certain significant factors affecting our financial condition and results of operations for the periods included in the accompanying condensed consolidated financial statements.

Overview

Founded in 1954, Nordson Corporation delivers precision technology solutions to help customers succeed worldwide. We engineer, manufacture and market differentiated products and systems used to dispense, apply and control adhesives, coatings, sealants, biomaterials, polymers, plastics and other materials, and fluid management; to test and inspect for quality; and to treat and cure surfaces. These products are supported with extensive application expertise and direct global sales and service. We serve a wide variety of consumer non-durable, consumer durable and technology end-markets including packaging, nonwovens, electronics, medical, appliances, energy, transportation, building and construction, and general product assembly and finishing. We have approximately 7,500 employees and direct operations in more than 35 countries.

Critical Accounting Policies and Estimates

The preparation and fair presentation of the consolidated unaudited interim financial statements and accompanying notes included in this report are the responsibility of management. The financial statements and footnotes have been prepared in accordance with U.S. generally accepted accounting principles for interim financial statements and contain certain amounts that were based upon management's best estimates, judgments and assumptions that were believed to be reasonable under the circumstances. On an ongoing basis, we evaluate the accounting policies and estimates used to prepare financial statements. Estimates are based on historical experience, judgments and assumptions believed to be reasonable under current facts and circumstances. Actual amounts and results could differ from these estimates used by management.

A comprehensive discussion of the Company's critical accounting policies and management estimates and significant accounting policies followed in the preparation of the financial statements is included in Item 7 of our Annual Report on Form 10-K for the year ended October 31, 2017. There have been no significant changes in critical accounting policies, management estimates or accounting policies followed since the year ended October 31, 2017.

Results of Operations

Sales

Sales – Worldwide sales for the three months ended April 30, 2018 were $553,706, an increase of 11.6% from sales of $496,137 for the comparable period of 2017. Sales volume increased 6.6%, consisting of 7.2% from the first year effect of the InterSelect GmbH, Vention and Sonoscan acquisitions, offset by a 0.6% decrease in organic volume. Favorable currency translation effects increased sales by 5.0%.

Sales of the Adhesive Dispensing Systems segment for the three months ended April 30, 2018 were $238,775 compared to $226,943 in the comparable period of 2017, an increase of $11,832, or 5.2%. The increase was due to favorable currency effects that increased sales 6.9%, which was offset by a sales volume decrease of 1.7%. Within this segment, sales volume increased in the Japan region and was offset by softness in other regions. Growth in the nonwovens product lines was offset by softness in product lines serving general product assembly, rigid packaging, and polymer processing end markets.

Sales of the Advanced Technology Systems segment for the three months ended April 30, 2018 were $250,839 compared to $210,142 in the comparable period of 2017, an increase of $40,697, or 19.4%. The increase was due to a sales volume increase of 16.2%, as well as favorable currency effects that increased sales by 3.2%. The sales volume increase consisted of 17.1% from the first year effect of acquisitions, offset by a 0.9% decrease in organic volume. Within this segment, sales volume, inclusive of acquisitions, increased in all geographic regions, except for the Japan and Asia Pacific regions.

Sales of the Industrial Coating Systems segment for the three months ended April 30, 2018 were $64,092 compared to $59,052 in the comparable period of 2017, an increase of $5,040, or 8.5%. The increase was due to a sales volume increase of 4.3%, as well as favorable currency effects that increased sales by 4.2%. Within this segment, sales volume increased in the Europe, Japan and Asia Pacific regions. Growth in powder, liquid and container product lines serving industrial end markets was offset by softness in UV curing and cold materials product lines serving industrial and automotive end markets.

Sales outside the United States accounted for 67.7% of our sales in the three months ended April 30, 2018 compared to 68.5% for the comparable period of 2017. On a geographic basis, sales in the United States were $178,821, an increase of 14.6% from 2017. The increase in sales volume consisted of 15.4% from acquisitions, offset by a decrease of 0.8% from organic volume. In the Americas region, sales were $38,959 an increase of 7.3% from 2017, with volume increasing 6.5%, and favorable currency effects of 0.8%. The increase in sales volume consisted of 7.7% from acquisitions, offset by a 1.2% decrease in organic volume. Sales in Europe were $154,736, an increase of 20.4% from 2017, with favorable currency effects of 13.4% and volume increasing 7.0%. The increase in sales volume consisted of 3.5% from acquisitions, and 3.5% in organic volume. Sales in Japan were $33,030, an increase of 7.0% from 2017, with favorable currency effects of 4.7% and volume increasing 2.3%. The increase in sales volume consisted of 1.3% from organic volume and 1.0% from acquisitions. Sales in the Asia Pacific region were $148,160, an increase of 2.6% from 2017, with favorable currency effects of 3.9%, offset by a decrease in sales volume of 1.3%. The decrease in sales volume consisted of a 4.3% organic volume decrease, offset by a 3.0% increase from acquisitions.

Worldwide sales for the six months ended April 30, 2018 were $1,104,130, a 22.2% increase from sales of $903,607 for the comparable period of 2017. Sales volume increased 17.4%, consisting of 8.1% organic growth and 9.3% from the first year effect of acquisitions. Favorable currency translation effects increased sales by 4.8%.

Sales of the Adhesive Dispensing Systems segment for the six months ended April 30, 2018 were $459,639 compared to $434,780 in the comparable period of 2017, an increase of 5.7%. The increase was the net result of favorable currency translation effect of 6.3%, partially offset by a sales volume decrease of 0.6%. Within this segment, sales volume increased in the Japan and Asia Pacific regions, and was offset by decreases in the United States, Europe and Americas regions. Growth in nonwowens and general product assembly product lines, was offset by softness in product lines serving rigid packaging and polymer processing end markets.

Sales of the Advanced Technology Systems segment for the six months ended April 30, 2018 were $522,540 compared to $355,502 in the comparable period of 2017, an increase of 47.0%. Sales volume increased 43.7%, consisting of 20.0% organic growth and 23.7% from the first year effect of acquisitions. Favorable currency translation effects increased sales by 3.3%. Within this segment, sales volume, inclusive of acquisitions, increased in all geographic regions and was most pronounced in the United States and Japan. Organic volume was driven by demand for most all product lines within this segment.

Sales of the Industrial Coating Systems segment for the six months ended April 30, 2018 were $121,951 compared to $113,325 in the comparable period of 2017, an increase of 7.6%. Sales volume increased 3.8% and favorable currency translation effects increased sales by 3.8%. Within this segment, sales volume increased in the Europe, Japan and Asia Pacific regions, and was offset by a decrease in the Americas region. Growth was driven by powder and container product lines serving industrial end markets.

Sales outside the United States accounted for 68.8% of sales in the six months ended April 30, 2018, the same as in the comparable period of 2017. On a geographic basis, sales in the United States were $344,652, an increase of 22.4% from 2017. The increase in sales volume consisted of 20.6% growth from acquisitions and 1.8% from organic volume. In the Americas region, sales were $73,238, an increase of 10.4% from 2017, with volume increasing 8.7%, and favorable currency effects of 1.7%. The increase in sales volume consisted of 11.6% from acquisitions, offset by 2.9% decrease in organic volume. Sales in Europe were $296,674, an increase of 19.8% from 2017, with volume increasing 7.4% and favorable currency effects of 12.4%. The increase in sales volume consisted of 4.3% from acquisitions and 3.1% from organic volume. Sales in Japan were $98,899, an increase of 79.7% from 2017, with volume increasing 76.5% and favorable currency effects of 3.2%. The increase in sales volume consisted of 74.7% from organic volume and 1.8% from acquisitions. Sales in the Asia Pacific region were $290,667, an increase of

14.9% from 2017, with volume increasing 10.9% and favorable currency effects of 4.0%. The increase in sales volume consisted of 8.3% from organic volume and 2.6% from acquisitions.

Operating profit – Cost of sales for the three months ended April 30, 2018 were $246,878, up from $220,625 in the comparable period of 2017. Gross profit, expressed as a percentage of sales, decreased slightly to 55.4% for this same period from 55.5% in 2017. Of the 0.1 percentage point decline in gross margin, unfavorable product mix contributed 1.0 percentage point. The 0.9 percentage point offset was due to favorable currency translation effects.

Cost of sales for the six months ended April 30, 2018 were $496,299, up 23.2% from the comparable period of 2017. Gross profit, expressed as a percentage of sales, decreased to 55.1% for this same period from 55.4% in 2017. Of the 0.3 percentage point decline in gross margin, unfavorable product mix contributed 1.1 percentage points, and short-term purchase price accounting charges for acquired inventory contributed 0.1 percentage points. The 0.9 percentage point offset is primarily due to favorable currency translation effects.

Selling and administrative expenses for the three months ended April 30, 2018 were $180,123, compared to $171,981 in the comparable period of 2017. The 4.7% increase includes 5.8% primarily in support of higher sales growth, 2.4% due to the first year effect of acquisitions, 4.0% due to currency translation effects and 0.3% due to severance and restructuring costs in the current period, offset by 7.8% due to lower acquisition transaction costs in the current quarter.

Selling and administrative expenses for the six months ended April 30, 2018 were $363,403, compared to $321,201 for the comparable period of 2017. The 13.1% increase includes 7.6% primarily in support of higher sales growth, 5.5% due to the first year effect of acquisitions, 3.7% due to favorable currency translation effects, and 0.5% due to higher severance and restructuring costs, offset by a 4.2% due to lower acquisition transaction costs in the current period.

Selling and administrative expenses as a percentage of sales decreased to 32.5% for the three months ended April 30, 2018 compared to 34.7% in the comparable period of 2017. Of the 2.2 percentage point improvement, 2.7 percentage points is due to lower acquisition transaction costs and 0.2 percentage points is due to favorable currency translation effects. This improvement was partially offset by 0.6 percentage points due to the first year effect of acquisitions, and 0.1 percentage points due to higher severance and restructuring expenses in the current period.

Selling and administrative expenses as a percentage of sales decreased to 32.9% for the six months ended April 30, 2018 from 35.5% for the comparable period of 2017. Of the 2.6 percentage point improvement, 2.6 percentage points is due leveraging higher sales growth, and 1.5 percentage points is primarily due to a decrease in acquisitions expenses, offset by 1.4 percentage points due to the first year effect of acquisition and 0.1 percentage points due to higher severance and restructuring expenses in the current year.

During the three and six months ended April 30, 2018, we recognized severance and restructuring costs of $1,082 and $2,149, respectively. During the three and six months ended April 30, 2017, we recognized severance and restructuring costs of $491 and $718, respectively. These costs were all recognized within our Adhesives Dispensing Systems segment, and are associated with a restructuring initiative to consolidate certain facilities in the U.S. Additional costs related to this initiative are not expected to be material in future periods. All severance and restructuring costs are included in selling and administrative expenses in the Condensed Consolidated Statements of Income.

Operating capacity for each of our segments can support fluctuations in order activity without significant changes in operating costs. Also, currency translation affects reported operating margins. Operating margins for each segment were favorably impacted by a weaker dollar primarily against the Euro, Japanese Yen and British Pound during 2018 as compared to 2017.

Operating profit as a percentage of sales increased to 22.9% for the three months ended April 30, 2018 compared to 20.9% for the comparable period of 2017. Of the 2.0 percentage point improvement in operating margin, lower acquisition transaction costs contributed 2.7 percentage points and favorable currency translation effects contributed 1.1 percentage points. This improvement was offset by 0.7 percentage points due to the first year effect of acquisitions, 1.0 percentage points due to unfavorable product mix, and 0.1 percentage points due to lower severance and restructuring expenses.

Operating profit as a percentage of sales increased to 22.1% for the six months ended April 30, 2018 compared to 19.9% for the comparable period of 2017. Of the 2.2 percentage point improvement in operating margin, favorable leverage of our selling and administrative expenses contributed 2.6 percentage points, lower acquisition transaction costs contributed 1.5 percentage points, and favorable currency translation effects contributed 0.9 percentage points. This improvement was offset by 1.5 percentage points due to the first year effect of acquisitions, 1.1 percentage points due to dilution in gross margin related to the consolidation of certain facilities in the U.S., 0.1 percentage points due to higher severance and restructuring expenses, and 0.1 percentage points due to short-term purchase price accounting charges for acquired inventory.

For the Adhesive Dispensing Systems segment, operating profit as a percentage of sales increased to 29.1% for the three months ended April 30, 2018 compared to 29.0% for the comparable period of 2017. Of the 0.1 percentage point increase in operating margin, favorable currency translation effects contributed 1.2 percentage points. This increase was offset by 0.3 percentage points due to unfavorable product mix, 0.5 percentage points due to unfavorable leverage of selling and administrative expenses, and 0.3 percentage points due to higher severance and restructuring expenses.

For the Adhesive Dispensing Systems segment, operating profit as a percentage of sales decreased to 26.7% for the six months ended April 30, 2018 compared to 27.3% for the comparable period of 2017. Of the 0.6 percentage point decline in operating margin, dilution in gross margin of 0.8 percentage points was due to the consolidation of certain facilities in the U.S., unfavorable leverage of selling and administrative expenses contributed 0.7 percentage points, and higher severance and restructuring expenses contributed 0.3 percentage points. These decreases were offset by a 1.2 percentage point increase due to favorable currency translation effects.

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For the Advanced Technology Systems segment, operating profit as a percentage of sales decreased to 23.2% for the three months ended April 30, 2018 compared to 25.8% for the comparable period of 2017. Of the 2.6 percentage point decline in operating margin, 1.6 percentage points is due to incremental amortization expense due to acquisitions and 1.0 percent point is due to short-term purchase accounting charges for acquired inventory.

For the Advanced Technology Systems segment, operating profit as a percentage of sales increased to 24.0% for the six months ended April 30, 2018 compared to 22.7% for the comparable period of 2017. Of the 1.3 percentage point increase in operating margin, favorable leverage of our selling and administrative expenses from base business contributed to 3.5 percentage points and favorable currency translation effects contributed 0.5 percentage points. These increases were offset by 2.0 percentage points due incremental amortization expense due to acquisitions, and 0.7 percentage points due to short-term purchase price accounting charges for acquired inventory.

For the Industrial Coating Systems segment, operating profit as a percentage of sales increased to 18.1% for the three months ended April 30, 2018 compared to 17.4% for the comparable period of 2017. Of the 0.7 percentage point increase in operating margin, favorable leverage of our selling and administrative expenses added 1.2 percentage points, and favorable currency translation effects contributed 1.1 percentage points. These increases were offset by 1.6 percentage points due to unfavorable product mix.

For the Industrial Coating Systems segment, operating profit as a percentage of sales increased to 17.8% for the six months ended April 30, 2018 compared to 15.3% in 2017. Of the 2.5 percentage point improvement in operating margin, favorable leverage of selling and administrative expenses added 1.0 percentage point, favorable currency translation effects contributed 1.1 percentage points, and favorable product mix contributed 0.4 percentage points.

Interest and other income (expense) - Interest expense for the three months ended April 30, 2018 was $12,127, up from $7,907 for the comparable period of 2017. Interest expense for the six months ended April 30, 2018 was $23,445, up from $13,548 for the comparable period of 2017. These increases were due primarily to higher borrowing levels between periods.

Other income was $3,322 for the three months ended April 30, 2018, compared to other expense of $1,323 for the comparable period of 2017. Included in the current quarter's other income were a non-recurring gain of $2,512 and foreign currency gains of $978. Included in the prior year's other expense were foreign currency losses of $985.

Other income was $145 for the six months ended April 30, 2018, compared to other expense of $1,480 for the comparable period of 2017. Included in the current year's other income were a non-recurring gain of $2,512, offset by $748 related to the write off of building improvements. Included in the prior year's other expense were foreign currency losses of $995.

Income taxes – We record our interim provision for income taxes based on our estimated annual effective tax rate, as well as certain items discrete to the current period. Significant judgment is involved regarding the application of global income tax laws and regulations and when projecting the jurisdictional mix of income. We have considered several factors in determining the probability of realizing deferred income tax assets which include forecasted operating earnings, available tax planning strategies and the time period over which the temporary differences will reverse. We review our tax positions on a regular basis and adjust the balances as new information becomes available.

The effective tax rates for the three and six months ended April 30, 2018 were 22.8% and 11.7%, respectively. The effective tax rate for the three and six months ended April 30, 2017 were 31.8% and 30.6%, respectively. The effective tax rate for the current quarter was lower than the comparable prior year period primarily due to recently enacted law commonly referred to as the U.S. Tax Cuts and Jobs Act ("the Act") as set forth below.

The Act was enacted into law on December 22, 2017. It reduces the U.S. federal corporate income tax rate from 35% to 21%. We have an October 31 fiscal year-end; therefore, the lower corporate income tax rate will be phased in, resulting in a U.S. statutory federal rate of 23.3% for our fiscal year ending October 31, 2018, and 21% for subsequent fiscal years. The statutory tax rate of 23.3% was applied to earnings in the current quarter.

The Act requires us to revalue our existing U.S. deferred tax balance to reflect the lower statutory tax rate and pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously deferred from U.S. tax. As a result, during the first quarter of 2018, we recorded a provisional tax benefit of $45,213 to reflect the revaluation of our tax assets and liabilities at the reduced corporate tax rate. We also recorded a provisional tax expense of $23,124 to reflect the transition tax on previously deferred foreign earnings. The net tax effect of these discrete items resulted in a decrease of $22,089 in income tax expense for the six months ended April 30, 2018. We intend to pay the transition tax in installments over the eight year period allowable under the Act. The transition tax is primarily included in other long-term liabilities in the Consolidated Balance Sheet at April 30, 2018. The amounts recorded are considered a provisional estimate under the U.S. Securities and Exchange Commission Staff Accounting Bulletin No.

118. The provisional calculations may change after the underlying temporary differences and foreign earnings are finalized. Furthermore, we are still analyzing certain aspects of the Act and related interpretive guidance and refining our calculations which could potentially affect the measurement of these balances or potentially give rise to new or additional deferred tax amounts.

The Act also establishes new tax laws that will affect future tax years, including, but not limited to, the creation of the base erosion anti-abuse tax, impact of foreign derived intangible income, and a new provision designed to tax global intangible low-taxed income. These provisions are not effective until our fiscal year ending October 31, 2019 and, as such, have not been incorporated into the current period tax provision. We continue to evaluate the future impact of these provisions and there can be no assurance of what impact these provisions or the Act in its totality will have on our business, financial condition and results of operations. In addition, in the absence of guidance on various uncertainties and ambiguities in the application of certain provisions of the Act, we will use what we believe are reasonable interpretations and assumptions in applying the Act, but it is possible that the Internal Revenue Service could issue subsequent guidance or take positions on audit that differ from our prior interpretations and assumptions, which could materially adversely impact our cash, tax liabilities, financial condition and results of operations.

In March 2016, the FASB issued a new standard which simplifies the accounting for share-based payment transactions, which we adopted during the first quarter of 2018. This guidance requires that excess tax benefits and tax deficiencies be recognized as income tax expense or benefit in the Consolidated Statements of Income rather than as additional paid-in capital. As a result, our income tax provision for the three and six months ended April 30, 2018 includes a discrete tax benefit of $2,202 and $6,950, respectively.

During the three months ended April 30, 2017, we recorded a discrete tax expense of $2,600 related to nondeductible acquisition costs.

Net income – Net income for the three months ended April 30, 2018 was $91,235, or $1.55 per diluted share, compared to $64,523, or $1.11 per diluted share, in the same period of 2017. This represents a 41.4% increase in net income and a 39.6% increase in diluted earnings per share. For the six months ended April 30, 2018, net income was $195,790, or $3.32 per diluted share, compared to $114,511, or $1.97 per diluted share, in the same period of 2017. This represents a 71.0% increase in net income and a 68.5% increase in diluted earnings per share. The impact on net income and diluted earnings per share due to the Act for the six months ended April 30, 2018 was a benefit of $22,089 and $0.37, respectively.

Foreign Currency Effects

In the aggregate, average exchange rates for 2018 used to translate international sales and operating results into U.S. dollars were favorable compared with average exchange rates existing during 2017. It is not possible to precisely measure the impact on operating results arising from foreign currency exchange rate changes, because of changes in selling prices, sales volume, product mix and cost structure in each country in which we operate. However, if transactions for the three months ended April 30, 2018 were translated at exchange rates in effect during the same period of 2017, sales would have been approximately $24,696 lower while third-party costs and expenses would have been approximately $12,848 lower. If transactions for the six months ended April 30, 2018 were translated at exchange rates in effect during the same period of 2017, sales would have been approximately $43,660 lower while third-party costs and expenses would have been approximately $23,288 lower.

Financial Condition

Liquidity and Capital Resources

During the six months ended April 30, 2018, cash and cash equivalents increased $65,563. Cash provided by operations during this period was $212,311, compared to $144,272 for the six months ended April 30, 2017. Cash of $216,303 was generated from net income adjusted for non-cash income and expenses (consisting of depreciation and amortization, non-cash stock compensation, deferred income taxes, other non-cash expense and (gain)loss on sale of property, plant and equipment), compared to $165,556 for the comparable period of 2017. Changes in operating assets and liabilities reduced cash by $3,992 in the six months ended April 30, 2018, compared to a reduction of $21,284 in the comparable period of 2017.

Cash used in investing activities was $76,990 for the six months ended April 30, 2018, compared to $833,743 in the comparable period of 2017. During the six months ended April 30, 2018, cash of $44,176 was used for the Sonoscan acquisition and $805,218 was used for acquisitions during the six months ended April 30, 2017. Capital expenditures in the six months ended April 30, 2018 were $33,049, compared to $27,029 in the comparable period of 2017, due primarily to U.S. facility consolidation efforts.

Cash used in financing activities was $72,108 for the six months ended April 30, 2018, compared to $708,941 provided in the comparable period of the prior year. Net repayments of long-term debt and short-term borrowings used $45,173, compared to net proceeds of $733,870 in the prior year. Included in the prior year's net proceeds was our $705,000 term loan facility used for the Vention acquisition during the second quarter of 2017. During the six months ended April 30, 2018, cash of $5,005 was used for the purchase of treasury shares tendered for taxes related to vesting of restricted stock and cash of $34,697 was used for dividend payments, compared to $3,098 and $30,999, respectively, in the comparable period of 2017. Issuance of common shares related to employee benefit plans generated $15,595 compared to $12,040 in the comparable period of 2017.

The following is a summary of significant changes in balance sheet captions from October 31, 2017 to April 30, 2018. Inventories increased $20,097 primarily due to the acquisition of Sonoscan and expected order activity in the third quarter. Net property, plant and equipment increased $13,078 due to capital expenditures of $33,049, offset by depreciation expense. Goodwill increased $27,590 due primarily to the Sonoscan acquisition and the effects of foreign currency translation. The decrease of $22,115 in accrued liabilities was primarily due to compensation adjustments and bonuses paid out in the first quarter. The decrease in deferred income taxes liability of $43,926 was primarily due to the impact of the Act.

In December 2014, the board of directors authorized a $300,000 common share repurchase program. This program replaced the $200,000 program approved by the board in August 2013. In August 2015, the board of directors authorized the repurchase of up to an additional $200,000 of the Company's common shares. This new authorization added capacity to the board's December 2014 authorization to repurchase $300,000 of shares. Approximately $118,971 remained available for share repurchases at April 30, 2018. Uses for repurchased shares include the funding of benefit programs including stock options, restricted stock and 401(k) matching. Shares purchased are treated as treasury shares until used for such purposes. The repurchase program is being funded using cash from operations and proceeds from borrowings under our credit facilities.

Contractual Obligations

In March 2017, we entered into a $705,000 term loan facility with a group of banks. The Term Loan Agreement provides for the following term loans in three tranches: $200,000 due in September 2018, $200,000 due in March 2020, and $305,000 due in March 2022. The weighted average interest rate for borrowings under this agreement was 2.99% at April 30 2018. Borrowings under this agreement were used for the single purpose of acquiring Vention during the second quarter of 2017. We were in compliance with all covenants at April 30, 2018. On May 17, 2018, we entered into a Second Amendment to our $705,000 term loan facility to extend the maturity due date of the $200,000 tranche from September 30, 2018 to September 30, 2021. Refer to Note 14 for additional information.

In February 2015, we increased, amended and extended our existing syndicated revolving credit agreement that was scheduled to expire in December 2016. We entered into a $600,000 unsecured, multicurrency credit facility with a group of banks. This facility has a five-year term and includes a $50,000 subfacility for swing-line loans and may be increased from $600,000 to $850,000 under certain conditions. It expires in February 2020. Balances outstanding under the prior facility were transferred to the new facility. At April 30, 2018, $316,631 was outstanding under this facility, compared to $249,138 outstanding at October 31, 2017. The weighted average interest rate for borrowings under this agreement was 2.90% at April 30, 2018. We were in compliance with all covenants at April 30, 2018, and the amount we could borrow under the facility would not have been limited by any debt covenants.

We entered into a $150,000 three-year Note Purchase and Private Shelf agreement with New York Life Investment Management LLC in 2011. In 2015, the amount of the facility was increased to $180,000, and in 2016 it was increased to $200,000. Notes issued under the agreement may have a maturity of up to 12 years, with an average life of up to 10 years, and are unsecured. The interest rate on each note can be fixed or floating and is based upon the market rate at the borrowing date. At April 30, 2018 and October 31, 2017, $146,666 was outstanding under this facility. Existing notes mature between September 2018 and September 2026 and bear interest at fixed rates between 2.21% and 2.56%, and floating interest rates between 3.14% and 3.58% per annum. This agreement contains customary events of default and covenants related to limitations on indebtedness and the maintenance of certain financial ratios. We were in compliance with all covenants at April 30, 2018, and the amount we could borrow would not have been limited by any debt covenants.

In 2012, we entered into a Note Purchase Agreement with a group of insurance companies under which we sold $200,000 of Senior Notes. At April 30, 2018 and October 31, 2017 $172,600 was outstanding under this agreement. Existing notes mature between July 2018 and July 2025 and bear interest at fixed rates between 2.62% and 3.13%. We were in compliance with all covenants at April 30, 2018.

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In April 2015, we entered into a $200,000 term loan facility with a group of banks, of which $100,000 was paid in April 2018 and $100,000 is due in April 2020 with a weighted average interest rate of 2.34%. This loan was used to pay down $100,000 of our previous 364-day unsecured credit facility and $100,000 of our revolving credit facility. We were in compliance with all covenants at April 30, 2018.

In July 2015, we entered into a Note Purchase Agreement under which $100,000 of Senior Unsecured Notes were purchased primarily by a group of insurance companies. The notes start to mature in July 2019 and mature through July 2027 and bear interest at fixed rates of 2.89% and 3.19%. We were in compliance with all covenants at April 30, 2018.

Outlook

For the balance of the year, we expect to generate sales volume growth, including the first year effect of acquisitions, and we remain optimistic about longer term growth opportunities in the diverse consumer durable, non-durable, medical, electronics and industrial end markets we serve. Though the pace of improvement in the global economy remains unclear, our growth potential has been demonstrated over time from our capacity to build and enhance our core businesses by entering emerging markets and pursuing market adjacencies. We drive value for our customers through our application expertise, differentiated technology, and direct sales and service support. Our priorities also are focused on operational efficiencies by employing continuous improvement methodologies in our business processes. We expect our efforts will continue to provide more than sufficient cash from operations for meeting our liquidity needs and paying dividends to common shareholders, as well as enabling us to invest in the development of new applications and markets for our technologies. We believe our cash provided from operations, our available borrowing capacity, and ready access to capital markets is more than adequate to fund our liquidity needs within the next year and to make other opportunistic investments.

For the third quarter of 2018, sales are expected to be up 1% to down 3% as compared to the third quarter a year ago. This outlook includes a range for organic volume to be down 2% to 6%, 1% growth from the first year effect of acquisitions, and 2% favorable currency translation effects based on the current exchange rate environment. Diluted earnings per share are expected to be in the range of $1.47 to $1.63.

Safe Harbor Statements Under The Private Securities Litigation Reform Act Of 1995

This Form 10-Q, particularly the “Management’s Discussion and Analysis”, contains forward-looking statements within the meaning of the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. Such statements relate to, among other things, income, earnings, cash flows, changes in operations, operating improvements, businesses in which we operate and the U.S. and global economies. Statements in this Form 10-Q that are not historical are hereby identified as “forward-looking statements” and may be indicated by words or phrases such as “anticipates”, “supports”, “plans”, “projects”, “expects”, “believes”, “should “would”, “could”, “hope”, “forecast”, “management is of the opinion”, use of the future tense and similar words or phrases.

In light of these risks and uncertainties, actual events and results may vary significantly from those included in or contemplated or implied by such statements. Readers are cautioned not to place undue reliance on such forward-looking statements. These forward-looking statements speak only as of the date made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

Factors that could cause actual results to differ materially from the expected results are discussed in Item 1A, Risk Factors in our Form 10-K for the year ended October 31, 2017.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Information regarding our financial instruments that are sensitive to changes in interest rates and foreign currency exchange rates was disclosed in our Form 10-K for the year ended October 31, 2017. The information disclosed has not changed materially in the interim period since then.

ITEM 4. CONTROLS AND PROCEDURES

Our management with the participation of the principal executive officer (President and Chief Executive Officer) and principal financial officer (Executive Vice President, Chief Financial Officer) has reviewed and evaluated our disclosure controls and procedures (as defined in the Securities Exchange Act Rule 13a-15(e)) as of April 30, 2018. Based on that evaluation, our management, including the principal executive and financial officers, has concluded that our disclosure controls and procedures were effective as of April 30, 2018 in ensuring that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and is accumulated and communicated to management, including the principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in our internal controls over financial reporting that occurred during the three months ended April 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Part II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are involved in pending or potential litigation regarding environmental, product liability, patent, contract, employee and other matters arising from the normal course of business. Including the environmental matter discussed below, it is our opinion, after consultation with legal counsel, that resolutions of these matters are not expected to result in a material effect on our financial condition, quarterly or annual operating results or cash flows.

We have voluntarily agreed with the City of New Richmond, Wisconsin and other Potentially Responsible Parties to share costs associated with the remediation of the City of New Richmond municipal landfill (the "Site") and the construction of a potable water delivery system serving the impacted area down gradient of the Site. At April 30, 2018 and October 31, 2017, our accrual for the ongoing operation, maintenance and monitoring obligation at the Site was $472. The liability for environmental remediation represents management's best estimate of the probable and reasonably estimable undiscounted costs related to known remediation obligations. The accuracy of our estimate of environmental liability is affected by several uncertainties such as additional requirements that may be identified in connection with remedial activities, the complexity and evolution of environmental laws and regulations, and the identification of presently unknown remediation requirements. Consequently, our liability could be greater than our current estimate. However, we do not expect that the costs associated with remediation will have a material adverse effect on our financial condition or results of operations.

ITEM 1A. RISK FACTORS

Information regarding our risk factors was disclosed in our Form 10-K filed for the year ended October 31, 2017. The information disclosed has not changed materially in 2018.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table summarizes common stock repurchased by the Company during the three months ended April 30, 2018:

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1)	Maximum Value of Shares that May Yet Be Purchased Under the Plans or Programs(1)
February 1, 2018 to February 28, 2018	—	—	—	$ 118,971
March 1, 2018 to March 31, 2018	—	—	—	$ 118,971
April 1, 2018 to April 30, 2018	—	—	—	$ 118,971
Total	—		—	

(1) In December 2014, the board of directors authorized a $300,000 common share repurchase program. In August 2015, the board of directors authorized the repurchase of up to an additional $200,000 of the Company's common shares. This new authorization added capacity to the board's December 2014 authorization to repurchase $300,000 of shares. Approximately $118,971 remained available for share repurchases at April 30, 2018. Uses for repurchased shares include the funding of benefit programs including stock options, restricted stock and 401(k) matching. Shares purchased are treated as treasury shares until used for such purposes. The repurchase program

is being funded using cash from operations and proceeds from borrowings under our credit facilities.

ITEM 6. EXHIBITS

10.1	Amended and Restated Nordson Corporation 2012 Stock Incentive and Award Plan (incorporated herein by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K filed on March 2, 2018).**
10.2	Second Amendment to Term Loan Agreement dated as of May 17, 2018, by and between Nordson Corporation, as Borrower, each of the financial institutions party hereto, and PNC Bank, as Administrative Agent for the Lenders (incorporated herein by reference to Exhibit 10.1 to Registrant's Current Report of Form 8-K filed with the Securities and Exchange Commission on May 23, 2018).**
31.1	Certification pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934 by the Chief Executive Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934 by the Chief Financial Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
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	The following financial information from Nordson Corporation's Quarterly Report on Form 10-Q for the three and six months ended April 30, 2018, formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Statements of Income for the three and six months ended April 30, 2018 and 2017, (ii) the Condensed Consolidated Statements of Comprehensive Income for the three and six months ended April 30, 2018 and 2017, (iii) the Condensed Consolidated Balance Sheets at April 30, 2018 and October 31, 2017, (iv) the Condensed Consolidated Statements of Cash Flows for the six months ended April 30, 2018 and 2017, and (v) the Notes to Condensed Consolidated Financial Statements.

* Furnished herewith.
** Indicates management contract or compensatory plan, contract or arrangement in which one or more directors and/or executive officers of Nordson Corporation may be participants.

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SIGNATURE

Pursuant to the requirements 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.

Date: June 4, 2018	Nordson Corporation
	By: /s/ GREGORY A. THAXTON Gregory A. Thaxton Executive Vice President, Chief Financial Officer (Principal Financial Officer)

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