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

FORM 10-Q

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

For the quarterly period ended September 30, 2019

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: 001-38280

CBTX, INC.

(Exact name of registrant as specified in its charter)

Texas

(State or other jurisdiction of
incorporation or organization)

20-8339782

(I.R.S. employer
identification no.)

9 Greenway Plaza, Suite 110

Houston, Texas 77046

(Address of principal executive offices)

(713) 210-7600

(Registrant's telephone number, including area code)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common stock, par value \$0.01 per share	CBTX	The Nasdaq Global Select Market

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Large accelerated filer

Non-accelerated filer

Accelerated filer

Smaller reporting company

Emerging growth company

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

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

As of October 21, 2019, there were 26,016,468 shares of the registrant's common stock outstanding, including 236,433 shares of unvested restricted stock.

CBTX, INC.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements**CBTX, INC. AND SUBSIDIARY**
Condensed Consolidated Balance Sheets (Unaudited)
(Dollars in thousands, except par value and share amounts)

	<u>September 30,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
ASSETS		
Cash and due from banks	\$ 56,416	\$ 54,450
Interest-bearing deposits at other financial institutions	232,983	327,620
Total cash and cash equivalents	289,399	382,070
Securities	228,061	229,964
Equity investments	19,220	13,026
Loans, net of allowance for loan loss of \$25,576 and \$23,693 at September 30, 2019 and December 31, 2018, respectively	2,651,248	2,423,130
Premises and equipment, net of accumulated depreciation of \$32,128 and \$29,867 at September 30, 2019 and December 31, 2018, respectively	51,183	51,622
Goodwill	80,950	80,950
Other intangible assets, net of accumulated amortization of \$15,593 and \$14,915 at September 30, 2019 and December 31, 2018, respectively	5,106	5,775
Bank-owned life insurance	71,451	71,525
Operating lease right-to-use asset	12,864	—
Deferred tax asset, net	7,094	7,201
Other assets	15,009	13,833
Total assets	<u>\$ 3,431,585</u>	<u>\$ 3,279,096</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Noninterest-bearing deposits	\$ 1,196,720	\$ 1,183,058
Interest-bearing deposits	1,547,607	1,583,224
Total deposits	2,744,327	2,766,282
Repurchase agreements	1,208	2,498
Federal Home Loan Bank advances	120,000	—
Junior subordinated debt	—	1,571
Operating lease liabilities	15,513	—
Other liabilities	25,317	21,120
Total liabilities	<u>2,906,365</u>	<u>2,791,471</u>
Commitments and contingencies (Note 17)		
Shareholders' equity		
Preferred stock, \$0.01 par value, 10,000,000 shares authorized, no shares issued	—	—
Common stock, \$0.01 par value, 90,000,000 shares authorized, 25,780,035 and 25,777,693 shares issued at September 30, 2019 and December 31, 2018, 24,922,689 and 24,907,421 shares outstanding at September 30, 2019 and December 31, 2018, respectively	258	258
Additional paid-in capital	346,097	344,497
Retained earnings	190,960	160,626
Treasury stock, at cost, 857,346 and 870,272 shares held at September 30, 2019 and December 31, 2018, respectively	(14,562)	(14,781)
Accumulated other comprehensive gain (loss), net of tax of \$656 and (\$791) at September 30, 2019 and December 31, 2018, respectively	2,467	(2,975)
Total shareholders' equity	<u>525,220</u>	<u>487,625</u>
Total liabilities and shareholders' equity	<u>\$ 3,431,585</u>	<u>\$ 3,279,096</u>

See accompanying notes to condensed consolidated financial statements.

CBTX, INC. AND SUBSIDIARY
Condensed Consolidated Statements of Income (Unaudited)
(Dollars in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Interest income				
Interest and fees on loans	\$ 36,353	\$ 31,513	\$ 105,754	\$ 90,468
Securities	1,436	1,535	4,512	4,478
Other interest-earning assets	1,212	1,404	4,054	3,334
Equity investments	192	213	507	597
Total interest income	<u>39,193</u>	<u>34,665</u>	<u>114,827</u>	<u>98,877</u>
Interest expense				
Deposits	4,130	2,961	11,536	7,035
Federal Home Loan Bank advances and repurchase agreements	484	62	1,073	76
Note payable and junior subordinated debt	4	116	16	325
Total interest expense	<u>4,618</u>	<u>3,139</u>	<u>12,625</u>	<u>7,436</u>
Net interest income	<u>34,575</u>	<u>31,526</u>	<u>102,202</u>	<u>91,441</u>
Provision (recapture) for loan losses	<u>579</u>	<u>(1,142)</u>	<u>2,533</u>	<u>413</u>
Net interest income after provision for loan losses	<u>33,996</u>	<u>32,668</u>	<u>99,669</u>	<u>91,028</u>
Noninterest income				
Deposit account service charges	1,681	1,597	4,967	4,572
Net gain on sale of assets	190	152	347	492
Card interchange fees	908	922	2,713	2,820
Earnings on bank-owned life insurance	430	443	4,581	1,359
Other	906	412	2,303	1,150
Total noninterest income	<u>4,115</u>	<u>3,526</u>	<u>14,911</u>	<u>10,393</u>
Noninterest expense				
Salaries and employee benefits	13,951	12,499	41,958	37,690
Net occupancy expense	2,484	2,428	7,089	7,126
Regulatory fees	144	488	1,054	1,546
Data processing	652	664	2,027	2,013
Software	469	400	1,334	1,168
Printing, stationery and office	313	291	993	858
Amortization of intangibles	221	245	678	748
Professional and director fees	1,455	809	5,828	2,414
Correspondent bank and customer related transaction expenses	67	66	198	201
Loan processing costs	124	102	343	295
Advertising, marketing and business development	407	437	1,379	1,418
Repossessed real estate and other asset expense	—	3	—	65
Security and protection expense	410	346	1,100	959
Telephone and communications	434	342	1,268	1,122
Other expenses	914	844	2,784	2,637
Total noninterest expense	<u>22,045</u>	<u>19,964</u>	<u>68,033</u>	<u>60,260</u>
Net income before income tax expense	<u>16,066</u>	<u>16,230</u>	<u>46,547</u>	<u>41,161</u>
Income tax expense	<u>2,990</u>	<u>3,207</u>	<u>8,666</u>	<u>7,984</u>
Net income	<u>\$ 13,076</u>	<u>\$ 13,023</u>	<u>\$ 37,881</u>	<u>\$ 33,177</u>
Earnings per common share				
Basic	\$ 0.52	\$ 0.52	\$ 1.52	\$ 1.34
Diluted	\$ 0.52	\$ 0.52	\$ 1.51	\$ 1.33

See accompanying notes to condensed consolidated financial statements.

CBTX, INC. AND SUBSIDIARY
Condensed Consolidated Statements of Comprehensive Income (Unaudited)
(Dollars in thousands)

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
Net income	\$ 13,076	\$ 13,023	\$ 37,881	\$ 33,177
Change in unrealized gains (losses) on securities available for sale arising during the period, net	1,084	(1,957)	6,831	(6,583)
Reclassification adjustments for net realized gains included in net income	54	23	57	23
Change in related deferred income tax	(239)	407	(1,446)	1,378
Other comprehensive income (loss), net of tax	899	(1,527)	5,442	(5,182)
Total comprehensive income	<u>\$ 13,975</u>	<u>\$ 11,496</u>	<u>\$ 43,323</u>	<u>\$ 27,995</u>

See accompanying notes to condensed consolidated financial statements.

CBTX, INC. AND SUBSIDIARY
Condensed Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
(Dollars in thousands, except share amounts)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock		Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount			Shares	Amount		
Nine Months Ended September 30, 2018:								
Balance at December 31, 2017	25,731,504	\$ 257	\$ 343,249	\$ 118,353	(898,272)	\$ (15,256)	\$ (389)	\$ 446,214
Net income	—	—	—	33,177	—	—	—	33,177
Dividends on common stock, \$0.15 per share	—	—	—	(3,762)	—	—	—	(3,762)
Exercise of stock options	—	—	(181)	—	25,400	431	—	250
Stock-based compensation expense	—	—	1,154	—	—	—	—	1,154
Other comprehensive loss, net of tax	—	—	—	—	—	—	(5,182)	(5,182)
Balance at September 30, 2018	25,731,504	\$ 257	\$ 344,222	\$ 147,768	(872,872)	\$ (14,825)	\$ (5,571)	\$ 471,851
Nine Months Ended September 30, 2019:								
Balance at December 31, 2018	25,777,693	\$ 258	\$ 344,497	\$ 160,626	(870,272)	\$ (14,781)	\$ (2,975)	\$ 487,625
Net income	—	—	—	37,881	—	—	—	37,881
Dividends on common stock, \$0.30 per share	—	—	—	(7,547)	—	—	—	(7,547)
Vesting of restricted stock, net of shares withheld for employee tax liabilities	2,442	—	(19)	—	—	—	—	(19)
Exercise of stock options, net of shares withheld for employee tax liabilities	—	—	(98)	—	12,926	219	—	121
Shares repurchased	(100)	—	(3)	—	—	—	—	(3)
Stock-based compensation expense	—	—	1,720	—	—	—	—	1,720
Other comprehensive income, net of tax	—	—	—	—	—	—	5,442	5,442
Balance at September 30, 2019	25,780,035	\$ 258	\$ 346,097	\$ 190,960	(857,346)	\$ (14,562)	\$ 2,467	\$ 525,220

See accompanying notes to condensed consolidated financial statements.

CBTX, INC. AND SUBSIDIARY
Condensed Consolidated Statements of Quarterly Changes in Shareholders' Equity (Unaudited)
(Dollars in thousands, except share amounts)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock		Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount			Shares	Amount		
Three Months Ended September 30, 2018:								
Balance at June 30, 2018	25,731,504	\$ 257	\$ 343,807	\$ 136,000	(872,872)	\$ (14,825)	\$ (4,044)	\$ 461,195
Net income	—	—	—	13,023	—	—	—	13,023
Dividends on common stock, \$0.05 per share	—	—	—	(1,255)	—	—	—	(1,255)
Exercise of stock options	—	—	—	—	—	—	—	—
Stock-based compensation expense	—	—	415	—	—	—	—	415
Other comprehensive loss, net of tax	—	—	—	—	—	—	(1,527)	(1,527)
Balance at September 30, 2018	<u>25,731,504</u>	<u>\$ 257</u>	<u>\$ 344,222</u>	<u>\$ 147,768</u>	<u>(872,872)</u>	<u>\$ (14,825)</u>	<u>\$ (5,571)</u>	<u>\$ 471,851</u>
Three Months Ended September 30, 2019:								
Balance at June 30, 2019	25,780,135	\$ 258	\$ 345,495	\$ 180,401	(857,466)	\$ (14,564)	\$ 1,568	\$ 513,158
Net income	—	—	—	13,076	—	—	—	13,076
Dividends on common stock, \$0.10 per share	—	—	—	(2,517)	—	—	—	(2,517)
Vesting of restricted stock, net of shares withheld for employee tax liabilities	—	—	—	—	—	—	—	—
Exercise of stock options, net of shares withheld for employee tax liabilities	—	—	(3)	—	120	2	—	(1)
Shares repurchased	(100)	—	(3)	—	—	—	—	(3)
Stock-based compensation expense	—	—	608	—	—	—	—	608
Other comprehensive income, net of tax	—	—	—	—	—	—	899	899
Balance at September 30, 2019	<u>25,780,035</u>	<u>\$ 258</u>	<u>\$ 346,097</u>	<u>\$ 190,960</u>	<u>(857,346)</u>	<u>\$ (14,562)</u>	<u>\$ 2,467</u>	<u>\$ 525,220</u>

See accompanying notes to condensed consolidated financial statements.

CBTX, INC. AND SUBSIDIARY
Condensed Consolidated Statements of Cash Flows (Unaudited)
(Dollars in thousands)

	Nine Months Ended September 30,	
	2019	2018
Cash flows from operating activities:		
Net income	\$ 37,881	\$ 33,177
Adjustments to reconcile consolidated net income to net cash provided by operating activities:		
Provision for loan losses	2,533	413
Depreciation expense	2,408	2,483
Amortization of intangibles	678	748
Amortization of premiums on securities	881	841
Amortization of lease right-to-use assets	987	—
Accretion of lease liabilities	397	—
Earnings on bank-owned life insurance	(4,581)	(1,359)
Stock-based compensation expense	1,720	1,154
Deferred income tax benefit	(1,339)	(553)
Earnings on securities	(17)	(42)
Net gains on sales of assets	(347)	(492)
Change in operating assets and liabilities:		
Loans held for sale	162	1,398
Other assets	(784)	641
Operating lease liabilities	(1,391)	—
Other liabilities	5,015	(3,236)
Total adjustments	6,322	1,996
Net cash provided by operating activities	44,203	35,173
Cash flows from investing activities:		
Purchases of securities	(487,603)	(336,204)
Proceeds from sales, calls and maturities of securities	475,549	312,840
Principal repayments of securities	20,037	16,720
Net increase in loans	(261,172)	(163,908)
Sales of loan participations	30,330	40,871
Purchases of loan participations	(1,756)	(31,453)
Net contributions to equity investments	(6,194)	(2,875)
Net decrease in time deposits in other banks	—	600
Proceeds from sales of U.S. Small Business Administration loans	2,017	1,972
Redemption (purchases) of bank-owned life insurance	4,655	(1,700)
Proceeds from sales of repossessed real estate and other assets	103	856
Net purchases of premises and equipment	(2,001)	(909)
Proceeds from insurance claims	108	—
Net cash used in investing activities	(225,927)	(163,190)
Cash flows from financing activities:		
Net increase (decrease) in noninterest-bearing deposits	13,662	35,196
Net increase (decrease) in interest-bearing deposits	(35,617)	51,912
Net increase (decrease) in securities sold under agreements to repurchase	(1,290)	(174)
Proceeds from exercise of stock options	121	250
Payments to tax authorities for stock-based compensation	(19)	—
Net increase in Federal Home Loan Bank advances	120,000	—
Redemption of trust preferred securities	(1,571)	—
Dividends paid on common stock	(6,230)	(3,726)
Repurchase of common stock	(3)	—
Net cash provided by financing activities	89,053	83,458
Net decrease in cash, cash equivalents and restricted cash	(92,671)	(44,559)
Cash, cash equivalents and restricted cash, beginning	382,070	326,199
Cash, cash equivalents and restricted cash, ending	\$ 289,399	\$ 281,640

See accompanying notes to condensed consolidated financial statements.

CBTX, INC. AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements
(Unaudited)

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

CBTX, Inc., or the Company or CBTX, operates 35 branches, 19 in the Houston market area, 15 in the Beaumont/East Texas market area and one in Dallas, through its wholly-owned subsidiary, CommunityBank of Texas, N.A., or the Bank. The Bank provides relationship-driven commercial banking products and services primarily to small and mid-sized businesses and professionals with operations within the Bank's markets. The Bank operates under a national charter and therefore is subject to regulation by the Office of the Comptroller of the Currency, or OCC, and the Federal Deposit Insurance Corporation, or FDIC. The Company is subject to regulation by the Board of Governors of the Federal Reserve, or the Federal Reserve.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of the Company and the Bank. All material intercompany balances and transactions have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States, or GAAP, but do not include all the information and footnotes required for complete consolidated financial statements. In management's opinion, these interim unaudited condensed consolidated financial statements include all adjustments of a normal recurring nature necessary for a fair statement of the Company's consolidated financial position at September 30, 2019 and December 31, 2018, consolidated results of operations and consolidated shareholders' equity for the three and nine months ended September 30, 2019 and 2018, and consolidated cash flows for the nine months ended September 30, 2019 and 2018.

Accounting measurements at interim dates inherently involve greater reliance on estimates than at year end and the results for the interim periods shown in this report are not necessarily indicative of results to be expected for the full year due in part to global economic and financial market conditions, interest rates, access to sources of liquidity, market competition and interruptions of business processes. These interim unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto for the year ended December 31, 2018 included within the Company's Annual Report on Form 10-K.

Reclassification— Within interest income, equity investment income for 2018 has been reclassified from federal funds and other interest-earning assets to a separate line and within interest expense, repurchase agreements expense and interest expense on Federal Home Loan Bank, or FHLB, advances have been combined and interest expense on notes payable and junior subordinated debt have also been combined. On the December 31, 2018 balance sheet, repossessed real estate and other assets were combined with other assets. These reclassifications were made to conform to the 2019 financial statement presentation in the consolidated statements of income and consolidated balance sheets.

Share Repurchase Program

In July 2019, the Company's Board of Directors authorized a share repurchase program under which the Company may repurchase up to \$40.0 million of the Company's common stock through September 30, 2020. During the nine months ended September 30, 2019, 100 shares were repurchased at \$27.98 per share and retired and returned to the status of authorized but unissued shares.

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Accounting Standards Recently Adopted

The Company adopted Accounting Standards Update, or ASU 2016-02, Leases (Topic 842) on January 1, 2019, using the effective date as the date of initial adoption. The Company elected to apply certain practical expedients for transition, and under those expedients the Company did not reassess prior accounting decisions regarding the identification, classification and initial direct costs for leases existing at the effective date. The Company also elected to use hindsight in determining lease term when considering options to extend the lease and excluded short-term leases (defined as lease terms of 12 months or less). The Company elected to separate non-lease components from lease components in its application of ASU 2016-02. At adoption, the Company recorded right-of-use assets totaling \$13.2 million, which represented the Company's right to use, or control the use of, specified assets for their lease terms, and the Company recorded lease liabilities totaling \$15.5 million, which represented the Company's liability to make lease payments under these leases. Accrued lease obligations and lease incentive liabilities totaling \$2.3 million that were in other liabilities at December 31, 2018 were reversed as part of the adoption during the first quarter of 2019. The ASU 2016-02 standard applied to all leases existing at the date of initial adoption. The Company's financial statements and related footnotes were not updated for ASU 2016-02 for dates and periods before the date of adoption. See Note 16.

Accounting Standards Not Yet Adopted

ASU 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available for sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 will be effective on January 1, 2020.

The Company is finalizing its evaluation of the potential impact of ASU 2016-13 on the consolidated financial statements. The Company has developed a functional working group, with the assistance of an outside consultant, that is comprised of individuals from various areas including credit, risk management, and accounting, among others. The Company is currently finalizing its implementation plan related to the assessment and documentation of the methodology to be utilized, the processes and internal controls related to the estimation process, model development and validation, as well as system configuration. Existing technology is being adapted to conform to the requirements of ASU 2016-13 and the Company has implemented a third-party vendor solution to assist in the application of ASU 2016-13. The adoption of ASU 2016-13 will require changes to the Company's accounting policies and disclosures for credit losses on financial instruments. The Company has initiated running a parallel process that encompasses the functionality of the model including the validation and internal controls over the estimate process. The Company expects that the adoption of ASU 2016-13 will result in an increase in the allowance for loan losses as a result of changing from an incurred loss estimate to an expected loss estimate.

Cash Flow Reporting

Cash, cash equivalents and restricted cash include cash, interest-bearing and noninterest-bearing transaction accounts with other banks and federal funds sold. The Bank is required to maintain regulatory reserves with the Federal Reserve Bank and the reserve requirements for the Bank were \$18.2 million and \$18.5 million at September 30, 2019 and December 31, 2018, respectively. Additionally, as of September 30, 2019 and December 31, 2018, the Company had \$3.8 million and \$1.6 million, respectively, in cash collateral for interest rate swap transactions.

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Supplemental disclosures of cash flow information are as follows for the periods indicated below:

(Dollars in thousands)	Nine Months Ended September 30,	
	2019	2018
Supplemental disclosures of cash flow information:		
Cash paid for taxes	\$ 8,823	\$ 7,827
Cash paid for interest	12,349	7,243
Supplemental disclosures of non-cash flow information:		
Dividends accrued	1,317	44
Operating lease right-to-use asset obtained in exchange for lease liabilities	14,046	—
Repossessed real estate and other assets	77	312

NOTE 2: SECURITIES

The amortized cost and fair values of investments in securities as of the dates shown below were as follows:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2019				
Debt securities available for sale:				
State and municipal securities	\$ 51,240	\$ 1,862	\$ (8)	\$ 53,094
U.S. agency securities:				
Collateralized mortgage obligations	60,974	471	(106)	61,339
Mortgage-backed securities	111,550	1,203	(300)	112,453
Equity securities	1,149	—	(3)	1,146
Total	\$ 224,913	\$ 3,536	\$ (417)	\$ 228,032
Debt securities held to maturity:				
Mortgage-backed securities	\$ 29	\$ 2	\$ —	\$ 31

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2018				
Debt securities available for sale:				
State and municipal securities	\$ 57,972	\$ 345	\$ (626)	\$ 57,691
U.S. agency securities:				
Debt securities	17,315	—	(434)	16,881
Collateralized mortgage obligations	66,438	98	(1,122)	65,414
Mortgage-backed securities	90,845	230	(2,216)	88,859
Equity securities	1,129	—	(41)	1,088
Total	\$ 233,699	\$ 673	\$ (4,439)	\$ 229,933
Debt securities held to maturity:				
Mortgage-backed securities	\$ 31	\$ 1	\$ —	\$ 32

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The amortized cost and estimated fair value of securities, by contractual maturities, as of the dates shown below were as follows:

(Dollars in thousands)	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
September 30, 2019				
Amounts maturing in:				
1 year or less	\$ 2,536	\$ 2,542	\$ —	\$ —
1 year through 5 years	3,287	3,354	—	—
5 years through 10 years	13,861	14,205	—	—
After 10 years	205,229	207,931	29	31
	<u>\$ 224,913</u>	<u>\$ 228,032</u>	<u>\$ 29</u>	<u>\$ 31</u>
December 31, 2018				
Amounts maturing in:				
1 year or less	\$ 3,224	\$ 3,188	\$ —	\$ —
1 year through 5 years	22,784	22,370	—	—
5 years through 10 years	13,127	13,062	—	—
After 10 years	194,564	191,313	31	32
	<u>\$ 233,699</u>	<u>\$ 229,933</u>	<u>\$ 31</u>	<u>\$ 32</u>

Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Securities with a carrying amount of \$20.4 million and \$6.6 million were sold in the nine months ended September 30, 2019 and 2018, respectively. At September 30, 2019 and December 31, 2018, securities with a carrying amount of approximately \$58.1 million and \$49.9 million, respectively, were pledged to secure public deposits, repurchase agreements and for other purposes required or permitted by law.

The Company held 33 securities at September 30, 2019 and 100 securities at December 31, 2018, respectively, that were in a gross unrealized loss position for 12 months or more as illustrated in the table below. The unrealized losses are attributable primarily to changes in market interest rates relative to those available when the securities were acquired. The fair value of these securities is expected to recover as the securities reach their maturity or re-pricing date, or if changes in market rates for such investments decline. Management does not believe that any of the securities the Company holds are impaired due to reasons of credit quality and believes the unrealized losses detailed in the tables below are temporary. No impairment loss has been recorded in the Company's condensed consolidated statements of income for the nine months ended September 30, 2019 and 2018.

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Securities with unrealized losses as of the dates shown below, aggregated by category and the length of time were as follows:

(Dollars in thousands)	Less Than Twelve Months		Twelve Months or More	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
September 30, 2019				
Debt securities available for sale:				
State and municipal securities	\$ 2,043	\$ (7)	\$ 106	\$ (1)
U.S. agency securities:				
Collateralized mortgage obligations	10,514	(39)	8,580	(67)
Mortgage-backed securities	16,946	(40)	27,186	(260)
Equity securities	—	—	1,146	(3)
	<u>\$ 29,503</u>	<u>\$ (86)</u>	<u>\$ 37,018</u>	<u>\$ (331)</u>
December 31, 2018				
Debt securities available for sale:				
State and municipal securities	\$ 20,892	\$ (324)	\$ 6,584	\$ (302)
U.S. agency securities:				
Debt securities	—	—	16,882	(434)
Collateralized mortgage obligations	8,854	(81)	46,157	(1,041)
Mortgage-backed securities	21,745	(368)	46,183	(1,848)
Equity securities	—	—	1,088	(41)
	<u>\$ 51,491</u>	<u>\$ (773)</u>	<u>\$ 116,894</u>	<u>\$ (3,666)</u>

NOTE 3: EQUITY INVESTMENTS

The Company's unconsolidated investments that are considered equity securities as they represent ownership interests, such as common or preferred stock, were as follows for the dates indicated below.

(Dollars in thousands)	September 30, 2019	December 31, 2018
Federal Reserve stock	\$ 9,271	\$ 9,271
Federal Home Loan Bank stock	6,784	1,250
The Independent Bankers Financial Corporation stock	141	141
Community Reinvestment Act investments	3,024	2,364
	<u>\$ 19,220</u>	<u>\$ 13,026</u>

Banks that are members of the FHLB, are required to maintain a stock investment in the FHLB calculated as a percentage of aggregate outstanding mortgages, outstanding FHLB advances and other financial instruments. As a member of the Federal Reserve System, the Bank is required to annually subscribe to Federal Reserve Bank stock in specific ratios to the Bank's equity. Although FHLB and Federal Reserve Bank stock are considered equity securities, they do not have readily determinable fair values because ownership is restricted, and they lack a market. These investments can be sold back only at their par value of \$100 per share and can only be sold to the Federal Home Loan Banks or Federal Reserve Banks or to another member institution. In addition, the equity ownership rights are more limited than would be the case for a public company, because of the oversight role exercised by regulators in the process of budgeting and approving dividends. As a result, these investments are carried at cost and evaluated for impairment.

The Company also holds an investment in the stock of The Independent Bankers Financial Corporation, or TIB. This investment has limited marketability. As a result, these investments are carried at cost and evaluated for impairment. The Company has investments in two private investment funds and a limited partnership. These investments are qualified Community Reinvestment Act, or CRA, investments under the Small Business Investment Company program of the Small Business Administration, or SBA. There are limited to no observable price changes in orderly transactions for identical investments or similar investments from the same issuers that are actively traded and as a result, these investments are

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stated at cost. At September 30, 2019 and December 31, 2018, the Company had \$2.4 million and \$3.0 million, respectively, in outstanding unfunded commitments to these funds, which are subject to call.

The Company's equity investments are evaluated for impairment based on an assessment of qualitative indicators. Impairment indicators to be considered include, but are not limited to (i) a significant deterioration in the earnings, performance, credit rating, asset quality or business prospects of the investee, (ii) a significant adverse change in the regulatory, economic or technological environment of the investee, (iii) a significant adverse change in the general market conditions of either the geographical area or the industry in which the investee operates, (iv) a bona fide offer to purchase, an offer by the investee to sell, or completed auction process for the same or similar investment for an amount less than the carrying amount of that investment. There were no such qualitative indicators as of September 30, 2019.

NOTE 4: LOANS

Loans by loan class as of the dates shown below were as follows:

(Dollars in thousands)	September 30, 2019		December 31, 2018	
Commercial and industrial	\$ 523,831	19.5%	\$ 519,779	21.2%
Real estate:				
Commercial real estate	875,329	32.6%	795,733	32.4%
Construction and development	572,276	21.4%	515,533	21.0%
1-4 family residential	287,434	10.7%	282,011	11.5%
Multi-family residential	298,396	11.1%	221,194	9.0%
Consumer	37,975	1.4%	39,421	1.6%
Agriculture	10,836	0.4%	11,076	0.5%
Other	76,860	2.9%	68,382	2.8%
Total gross loans	2,682,937	100.0%	2,453,129	100.0%
Less allowance for loan loss	(25,576)		(23,693)	
Less deferred loan fees and unearned discounts	(6,113)		(6,306)	
Less loans held for sale	—		—	
Loans, net	<u>\$ 2,651,248</u>		<u>\$ 2,423,130</u>	

Accrued interest receivable for loans is \$8.1 million and \$6.8 million at September 30, 2019 and December 31, 2018, respectively, and is included in other assets in the condensed consolidated balance sheets.

From time to time, the Company will acquire and dispose of interests in loans under participation agreements with other financial institutions. Loan participations purchased and sold during the nine months ending September 30, 2019 and 2018, by loan class, were as follows:

(Dollars in thousands)	Participations Purchased During the Period	Participations Sold During the Period
September 30, 2019		
Commercial real estate	\$ 1,756	\$ 30,330
September 30, 2018		
Commercial and industrial	\$ 7,000	\$ —
Commercial real estate	24,453	35,000
Construction and development	—	5,871
	<u>\$ 31,453</u>	<u>\$ 40,871</u>

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The Company participates in the SBA loan program. When advantageous, the Company will sell the guaranteed portions of these loans with servicing retained. SBA loans that were sold with servicing retained during the nine months ended September 30, 2019 and 2018 totaled \$2.0 million and \$2.0 million respectively.

NOTE 5: LOAN PERFORMANCE

Nonaccrual loans, segregated by loan class, as of the dates shown below were as follows:

(Dollars in thousands)	September 30, 2019	December 31, 2018
Commercial and industrial	\$ 354	\$ 1,317
Real estate:		
Commercial real estate	159	1,517
1-4 family residential	629	656
Total	\$ 1,142	\$ 3,490

Interest income that would have been earned under the original terms of the nonaccrual loans was \$59,000 and \$220,000 for the nine months ended September 30, 2019 and 2018, respectively.

The following is an aging analysis of the Company's past due loans, segregated by loan class, as of the dates shown below:

(Dollars in thousands)	30 to 59 days past due	60 to 89 days past due	90 days or greater past due	Total past due	Total current loans	Total loans	90 days past due and still accruing
September 30, 2019							
Commercial and industrial	\$ 97	\$ 47	\$ —	\$ 144	\$ 523,687	\$ 523,831	\$ —
Real estate:							
Commercial real estate	1,885	—	50	1,935	873,394	875,329	—
Construction and development	—	—	—	—	572,276	572,276	—
1-4 family residential	142	—	32	174	287,260	287,434	—
Multi-family residential	—	—	—	—	298,396	298,396	—
Consumer	19	—	—	19	37,956	37,975	—
Agriculture	—	—	—	—	10,836	10,836	—
Other	—	—	—	—	76,860	76,860	—
Total loans	\$ 2,143	\$ 47	\$ 82	\$ 2,272	\$ 2,680,665	\$ 2,682,937	\$ —
December 31, 2018							
Commercial and industrial	\$ 178	\$ 881	\$ 154	\$ 1,213	\$ 518,566	\$ 519,779	\$ —
Real estate:							
Commercial real estate	68	1,089	605	1,762	793,971	795,733	—
Construction and development	359	4,204	—	4,563	510,970	515,533	—
1-4 family residential	395	111	36	542	281,469	282,011	—
Multi-family residential	—	—	—	—	221,194	221,194	—
Consumer	28	—	—	28	39,393	39,421	—
Agriculture	—	—	—	—	11,076	11,076	—
Other	—	—	—	—	68,382	68,382	—
Total loans	\$ 1,028	\$ 6,285	\$ 795	\$ 8,108	\$ 2,445,021	\$ 2,453,129	\$ —

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Loans restructured due to the borrower's financial difficulties during the nine months ended September 30, 2019 and 2018, which remained outstanding at the end of those periods were as follows:

(Dollars in thousands)	Number of Loans	Pre-modification Outstanding Recorded Investment	Post-modification recorded investment			
			Restructured Payments	Extended Maturity	Extended Maturity and Restructured Payments	Extended Maturity, Restructured Payments and Adjusted Interest Rate
September 30, 2019						
Commercial and industrial	2	\$ 163	\$ —	\$ —	\$ 163	\$ —
1-4 family residential	1	111	—	—	115	—
Total	3	\$ 274	\$ —	\$ —	\$ 278	\$ —
September 30, 2018						
Commercial and industrial	4	\$ 967	\$ 921	\$ —	\$ 46	\$ —
Commercial real estate	4	2,184	2,184	—	—	—
Total	8	\$ 3,151	\$ 3,105	\$ —	\$ 46	\$ —

The recorded investment in troubled debt restructurings was \$8.9 million and \$11.4 million as of September 30, 2019 and December 31, 2018, respectively. As of September 30, 2019 and December 31, 2018, \$368,000 and \$1.8 million of restructured loans were nonaccrual loans and \$8.5 million and \$9.6 million of restructured loans were accruing interest as of those periods. At December 31, 2018, the Company had an outstanding commitment to potentially fund \$2.1 million on a line of credit restructured prior to 2018. At September 30, 2019, the Company had no outstanding commitments to potentially fund additional funds to borrowers with loans that were restructured.

There were no loans modified as a troubled debt restructured loan within the previous 12 months and for which there was a payment default. For purposes of this disclosure, a default is a loan modified as a troubled debt restructuring where the borrower is 90 days past due or results in the foreclosure and repossession of the applicable collateral.

NOTE 6: ALLOWANCE FOR LOAN LOSSES

Activity in the allowance for loan losses segregated by loan class for the nine months ended September 30, 2019 and 2018, was as follows:

(Dollars in thousands)	Commercial and industrial	Real Estate				Consumer	Agriculture	Other	Total
		Commercial real estate	Construction and development	1-4 family residential	Multi-family residential				
September 30, 2019									
Beginning balance	\$ 7,719	\$ 6,730	\$ 4,298	\$ 2,281	\$ 1,511	\$ 387	\$ 62	\$ 705	\$ 23,693
Provision for loan loss	309	1,021	527	66	318	244	20	28	2,533
Charge-offs	(869)	(44)	—	(12)	—	(88)	—	(52)	(1,065)
Recoveries	311	81	—	3	—	15	—	5	415
Net (charge-offs) recoveries	(558)	37	—	(9)	—	(73)	—	(47)	(650)
Ending balance	\$ 7,470	\$ 7,788	\$ 4,825	\$ 2,338	\$ 1,829	\$ 558	\$ 82	\$ 686	\$ 25,576
Period-end amount allocated to:									
Specific reserve	\$ 373	\$ 22	\$ —	\$ 33	\$ —	\$ 142	\$ —	\$ 22	\$ 592
General reserve	7,097	7,766	4,825	2,305	1,829	416	82	664	24,984
Total	\$ 7,470	\$ 7,788	\$ 4,825	\$ 2,338	\$ 1,829	\$ 558	\$ 82	\$ 686	\$ 25,576

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(Dollars in thousands)	Commercial and industrial	Real Estate				Consumer	Agriculture	Other	Total
		Commercial real estate	Construction and development	1-4 family residential	Multi-family residential				
September 30, 2018									
Beginning balance	\$ 7,257	\$ 10,375	\$ 3,482	\$ 1,326	\$ 1,419	\$ 566	\$ 68	\$ 285	\$ 24,778
Provision (recapture) for loan loss	2,218	(3,467)	124	1,126	211	(173)	3	371	413
Charge-offs	(1,136)	(9)	—	(3)	—	(1)	—	(3)	(1,152)
Recoveries	424	14	—	5	—	2	—	2	447
Net (charge-offs) recoveries	(712)	5	—	2	—	1	—	(1)	(705)
Ending balance	\$ 8,763	\$ 6,913	\$ 3,606	\$ 2,454	\$ 1,630	\$ 394	\$ 71	\$ 655	\$ 24,486
Period-end amount allocated to:									
Specific reserve	\$ 542	\$ 1	\$ —	\$ 115	\$ —	\$ —	\$ —	\$ 127	\$ 785
General reserve	8,221	6,912	3,606	2,339	1,630	394	71	528	23,701
Total	\$ 8,763	\$ 6,913	\$ 3,606	\$ 2,454	\$ 1,630	\$ 394	\$ 71	\$ 655	\$ 24,486

The allowance for loan losses by loan category as of the periods indicated was as follows:

(Dollars in thousands)	September 30, 2019		December 31, 2018	
	Amount	Percent	Amount	Percent
Commercial and industrial	\$ 7,470	29.2 %	\$ 7,719	32.6 %
Real estate:				
Commercial real estate	7,788	30.5 %	6,730	28.4 %
Construction and development	4,825	18.9 %	4,298	18.1 %
1-4 family residential	2,338	9.1 %	2,281	9.6 %
Multi-family residential	1,829	7.1 %	1,511	6.4 %
Consumer	558	2.2 %	387	1.6 %
Agricultural	82	0.3 %	62	0.3 %
Other	686	2.7 %	705	3.0 %
Total allowance for loan losses	\$ 25,576	100.0 %	\$ 23,693	100.0 %

Allocation of a portion of the allowance to one category of loans above does not preclude its availability to absorb losses in other categories. In addition to the amounts indicated in the tables above, the Company has a reserve for loan losses on unfunded commitments of \$378,000 recorded in other liabilities as of September 30, 2019 and December 31, 2018.

Risk Grading

As part of the on-going monitoring of the credit quality of the Company's loan portfolio and methodology for calculating the allowance for loan losses, management assigns and tracks loan grades as described below that are used as credit quality indicators.

Pass—Credits in this category contain an acceptable amount of risk.

Special Mention—Credits in this category contain more than the normal amount of risk and are referred to as "special mention" in accordance with regulatory guidelines. These credits possess clearly identifiable temporary weaknesses or trends that, if not corrected or revised, may result in a condition that exposes the Company to higher level of risk of loss.

Substandard—Credits in this category are "substandard" in accordance with regulatory guidelines and of unsatisfactory credit quality with well-defined weaknesses or weaknesses that jeopardize the liquidation of the debt. Credits in this category are inadequately protected by the current sound worth and paying capacity of the obligor or the collateral pledged, if any. Often, the assets in this category will have a valuation allowance representative of management's estimated loss that is probable to be incurred. Loans deemed substandard and on nonaccrual status are considered impaired and are individually evaluated for impairment.

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Doubtful—Credits in this category are considered “*doubtful*” in accordance with regulatory guidelines, are placed on nonaccrual status and may be dependent upon collateral having a value that is difficult to determine or upon some near-term event which lacks certainty. Generally, these credits will have a valuation allowance based upon management’s best estimate of the losses probable to occur in the liquidation of the debt.

Loss—Credits in this category are considered “*loss*” in accordance with regulatory guidelines and are considered uncollectible and of such little value as to question their continued existence as assets on the Company’s financial statements. Such credits are to be charged off or charged down when payment is acknowledged to be uncertain or when the timing or value of payments cannot be determined. This category does not intend to imply that the debt or some portion of it will never be paid, nor does it in any way imply that the debt will be forgiven.

The Company had no loans graded “loss” or “doubtful” at September 30, 2019 and December 31, 2018.

Loans by risk grades and loan class as of the dates shown below were as follows:

(Dollars in thousands)	Pass	Special Mention	Substandard	Total Loans
September 30, 2019				
Commercial and industrial	\$ 507,785	\$ 4,160	\$ 11,886	\$ 523,831
Real estate:				
Commercial real estate	852,731	20,879	1,719	875,329
Construction and development	558,148	14,128	—	572,276
1-4 family residential	281,463	599	5,372	287,434
Multi-family residential	298,396	—	—	298,396
Consumer	37,724	—	251	37,975
Agriculture	10,756	50	30	10,836
Other	70,164	—	6,696	76,860
Total loans	\$ 2,617,167	\$ 39,816	\$ 25,954	\$ 2,682,937

(Dollars in thousands)	Pass	Special Mention	Substandard	Total Loans
December 31, 2018				
Commercial and industrial	\$ 504,425	\$ 5,768	\$ 9,586	\$ 519,779
Real estate:				
Commercial real estate	781,035	10,370	4,328	795,733
Construction and development	511,329	4,204	—	515,533
1-4 family residential	274,781	2,175	5,055	282,011
Multi-family residential	221,194	—	—	221,194
Consumer	39,140	246	35	39,421
Agriculture	11,048	—	28	11,076
Other	61,569	—	6,813	68,382
Total loans	\$ 2,404,521	\$ 22,763	\$ 25,845	\$ 2,453,129

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Loan Impairment Assessment

The recorded investment in impaired loans, as of the dates shown below by loan class and disaggregated based on the Company's impairment methodology was as follows:

(Dollars in thousands)	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment Year-to-Date
September 30, 2019						
Commercial and industrial	\$ 901	\$ 343	\$ 454	\$ 797	\$ 373	\$ 2,966
Real estate:						
Commercial real estate	1,527	945	574	1,519	22	2,416
1-4 family residential	4,158	2,227	1,786	4,013	33	4,108
Consumer	221	—	221	221	142	100
Other	6,693	5,451	1,241	6,692	22	6,815
Total loans	<u>\$ 13,500</u>	<u>\$ 8,966</u>	<u>\$ 4,276</u>	<u>\$ 13,242</u>	<u>\$ 592</u>	<u>\$ 16,405</u>

(Dollars in thousands)	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment Year-to-Date
December 31, 2018						
Commercial and industrial	\$ 4,378	\$ 3,642	\$ 635	\$ 4,277	\$ 525	\$ 5,771
Real estate:						
Commercial real estate	4,128	3,374	596	3,970	44	6,135
Construction and development	—	—	—	—	—	139
1-4 family residential	4,551	2,612	1,824	4,436	89	4,597
Consumer	—	—	—	—	—	7
Other	6,814	5,572	1,241	6,813	100	7,841
Total loans	<u>\$ 19,871</u>	<u>\$ 15,200</u>	<u>\$ 4,296</u>	<u>\$ 19,496</u>	<u>\$ 758</u>	<u>\$ 24,490</u>

Interest income recognized on impaired loans was \$517,000 and \$808,000 for the nine months ended September 30, 2019 and 2018, respectively.

The recorded investment in loans as of the dates shown below by loan class and based on the Company's impairment methodology was as follows:

(Dollars in thousands)	September 30, 2019			December 31, 2018		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total Loans	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total Loans
Commercial and industrial	\$ 797	\$ 523,034	\$ 523,831	\$ 4,277	\$ 515,502	\$ 519,779
Real estate:						
Commercial real estate	1,519	873,810	875,329	3,970	791,763	795,733
Construction and development	—	572,276	572,276	—	515,533	515,533
1-4 family residential	4,013	283,421	287,434	4,436	277,575	282,011
Multi-family residential	—	298,396	298,396	—	221,194	221,194
Consumer	221	37,754	37,975	—	39,421	39,421
Agriculture	—	10,836	10,836	—	11,076	11,076
Other	6,692	70,168	76,860	6,813	61,569	68,382
Total	<u>\$ 13,242</u>	<u>\$ 2,669,695</u>	<u>\$ 2,682,937</u>	<u>\$ 19,496</u>	<u>\$ 2,433,633</u>	<u>\$ 2,453,129</u>

At September 30, 2019 and December 31, 2018, the allowance allocated to specific reserves for loans individually evaluated for impairment was \$592,000 and \$758,000, respectively.

NOTE 7: PREMISES AND EQUIPMENT

Premises and equipment are summarized as follows as of the dates shown below:

(Dollars in thousands)	September 30, 2019	December 31, 2018
Land	\$ 13,466	\$ 13,466
Buildings and leasehold improvements	52,875	52,188
Furniture and equipment	15,787	15,426
Vehicles	203	232
Construction in progress	980	177
	83,311	81,489
Less accumulated depreciation	(32,128)	(29,867)
Premises and equipment, net	<u>\$ 51,183</u>	<u>\$ 51,622</u>

Depreciation expense was \$2.4 million and \$2.5 million for the nine months ended September 30, 2019 and 2018, respectively, which is included in net occupancy expense on the Company's condensed consolidated statements of income. A net loss of \$32,000 for dispositions of premises and equipment for the nine months ended September 30, 2019 was recognized and included in net gain on sale of assets in the condensed consolidated statements of income. There were no dispositions of premises and equipment in the nine months ended September 30, 2018.

NOTE 8: GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill was \$81.0 million at September 30, 2019 and December 31, 2018 and there have been no changes in goodwill during the nine months ended September 30, 2019 or the year ended December 31, 2018. Based on the results of the Company's assessment, management does not believe any impairment of goodwill or other intangible assets existed at September 30, 2019 or December 31, 2018. Other intangibles, net of accumulated amortization, were as follows as of the dates shown below:

(Dollars in thousands)	Weighted Amortization Period	Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets
September 30, 2019				
Core deposits	4.5 years	\$ 13,750	\$ (12,883)	\$ 867
Customer relationships	9.3 years	6,629	(2,541)	4,088
Servicing assets	12.8 years	320	(169)	151
Total other intangible assets, net		<u>\$ 20,699</u>	<u>\$ (15,593)</u>	<u>\$ 5,106</u>
December 31, 2018				
Core deposits	5.2 years	\$ 13,750	\$ (12,561)	\$ 1,189
Customer relationships	10.0 years	6,629	(2,209)	4,420
Servicing assets	14.4 years	311	(145)	166
Total other intangible assets, net		<u>\$ 20,690</u>	<u>\$ (14,915)</u>	<u>\$ 5,775</u>

Servicing Assets

Changes in the related servicing assets as of the dates indicated below were as follows:

(Dollars in thousands)	Nine Months Ended September 30,	
	2019	2018
Balance at beginning of year	\$ 166	\$ 209
Increase from loan sales	39	38
Decrease from serviced loans paid off or foreclosed	(30)	(22)
Amortization	(24)	(25)
Balance at end of period	<u>\$ 151</u>	<u>\$ 200</u>

NOTE 9: BANK OWNED LIFE INSURANCE

The Company has purchased life insurance policies on covered individuals, which are recorded at their cash surrender value. Changes in the cash surrender value of the policies are recorded in noninterest income. Gains or losses and proceeds from maturities are recognized in noninterest income upon the death of a covered employee, on receipt of a death notice or other verified evidence. During the nine months ended September 30, 2019, the Company received proceeds in the amount of \$4.7 million as the owner and beneficiary under a bank-owned life insurance policy as the result of the death of a former employee, and the Company recorded a gain of \$3.3 million.

Bank-owned life insurance policies and the net change in cash surrender value during the periods shown below were as follows:

(Dollars in thousands)	September 30, 2019	December 31, 2018
Balance at beginning of period	\$ 71,525	\$ 68,010
Purchases	—	1,700
Redemptions	(4,655)	—
Net change in cash surrender value	4,581	1,815
Balance at end of period	<u>\$ 71,451</u>	<u>\$ 71,525</u>

NOTE 10: DEPOSITS

Deposits as of the dates shown below were as follows:

(Dollars in thousands)	September 30, 2019	December 31, 2018
Interest-bearing demand accounts	\$ 337,746	\$ 387,457
Money market accounts	739,436	737,770
Saving accounts	91,413	96,962
Certificates and other time deposits, \$100,000 or greater	198,561	189,007
Certificates and other time deposits, less than \$100,000	180,451	172,028
Total interest-bearing deposits	<u>1,547,607</u>	<u>1,583,224</u>
Noninterest-bearing deposits	<u>1,196,720</u>	<u>1,183,058</u>
Total deposits	<u>\$ 2,744,327</u>	<u>\$ 2,766,282</u>

At September 30, 2019 and December 31, 2018, the Company had \$57.3 million and \$51.5 million in deposits from public entities and brokered deposits of \$117.2 million and \$104.5 million, respectively. Accrued interest payable for deposits was \$838,000 and \$594,000 at September 30, 2019 and December 31, 2018 and is included in other liabilities in the condensed consolidated balance sheets. The Company had no major concentrations of deposits at September 30, 2019 or December 31, 2018 from any single or related groups of depositors.

NOTE 11: LINES OF CREDIT

Frost Line of Credit

The Company has entered into a loan agreement, or the Loan Agreement, with Frost Bank, which provides for a \$30.0 million revolving line of credit, or Line of Credit. The Loan Agreement was amended and restated on December 13, 2018 and, as amended, is referred to as the Amended Agreement. The Company can make draws on the Line of Credit for a period of 12 months which began on December 13, 2018, after which the Company will not be permitted to make further draws and the outstanding balance will amortize over a period of 60 months. Interest accrues on outstanding borrowings at a rate equal to the maximum "Latest" U.S. prime rate of interest per annum and payable quarterly in the first 12 months and thereafter quarterly principal and interest payments are required over a term of 60 months. The entire outstanding balance and unpaid interest is payable in full on December 13, 2024.

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The Company may prepay the principal amount of any loan under the Amended Agreement without premium or penalty. The obligations of the Company under the Amended Agreement are secured by a valid and perfected first priority lien on all of the issued and outstanding shares of capital stock of the Bank.

Covenants made under the Amended Agreement include, among other things, the Company maintaining tangible net worth of not less than \$300 million, the Company maintaining free cash flow coverage ratio of not less than 1.25 to 1.00, the Bank's Texas Ratio (as defined under the Amended Agreement) not to exceed 15%, the Bank's Total Capital Ratio (as defined under the Amended Loan Agreement) of not less than 12% and restrictions on the ability of the Company and its subsidiaries to incur certain additional debt. The Company was in compliance with these covenants at September 30, 2019.

As of September 30, 2019, there were no outstanding borrowings on the Line of Credit and the Company has not drawn on this line since the Company entered into the Amended Agreement.

Additional Lines of Credit

The FHLB allows the Company to borrow on a blanket floating lien status collateralized by certain loans. As of September 30, 2019 and December 31, 2018, total borrowing capacity of \$950.8 million and \$919.9 million, respectively, was available under this arrangement. During the nine months ended September 30, 2019 and 2018, the Company borrowed under this agreement on a short-term basis. As of September 30, 2019, \$120.0 million of FHLB advances were outstanding with maturities of less than thirty days from September 30, 2019. At December 31, 2018, there were no outstanding FHLB advances. The average outstanding balance for FHLB advances for the nine months ended September 30, 2019 and 2018, was \$59.1 million and \$4.5 million, respectively. The weighted-average rate for the nine months ended September 30, 2019 and 2018, was 2.42% and 2.18%, respectively.

As of September 30, 2019 and December 31, 2018, the Company maintained four federal funds lines of credit with commercial banks that provide for the availability to borrow up to an aggregate of \$75.0 million, in federal funds. There were no funds under these lines of credit outstanding as of September 30, 2019 or December 31, 2018.

NOTE 12: JUNIOR SUBORDINATED DEBT

Prior to being acquired in 2007 by the Company, County Bancshares, Inc. received proceeds of junior subordinated debt held by a trust funded by common securities, all of which were purchased by County Bancshares, Inc. and trust preferred securities in the amount of \$5.5 million that were held by other investors. Funds raised by the trust totaling \$5.7 million were loaned to County Bancshares, Inc. in the form of junior subordinated debt. This debt was transferred to the Company at the date of acquisition. In 2015, the Company purchased \$4.1 million of the outstanding preferred securities, reducing the outstanding preferred securities to \$1.6 million.

In November 2018, the County Bancshares Trust I, or County Trust, agreed to redeem all of the County Trust's issued and outstanding trust preferred securities upon concurrent redemption made by the Company of its junior subordinated debt securities held by the County Trust on January 7, 2019. The Company paid \$5.7 million to pay its obligation for the junior subordinated debt, including accrued and unpaid interest. The Company received \$4.1 million from the redemption of the preferred securities.

NOTE 13: RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Company, through the Bank, has and expects to continue to conduct routine banking business with related parties, including its executive officers and directors. Related parties also include shareholders and their affiliates in which they directly or indirectly have 5% or more beneficial ownership in the Company.

Loans—In the opinion of management, loans to related parties were on substantially the same terms, including interest rates and collateral, as those prevailing at the time of comparable transactions with other persons and did not involve more than a normal risk of collectability or present any other unfavorable features to the Company. The Company had approximately \$158.7 million and \$169.0 million in loans to related parties at September 30, 2019 and December 31,

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2018, respectively. As of September 30, 2019 and December 31, 2018, there were no loans made to related parties deemed nonaccrual, past due, restructured or classified as potential problem loans.

Unfunded Commitments—At September 30, 2019 and December 31, 2018, the Company had approximately \$48.9 million and \$55.7 million in unfunded loan commitments to related parties, respectively.

Deposits—The Company held related party deposits of approximately \$234.7 million and \$311.2 million at September 30, 2019 and December 31, 2018, respectively.

NOTE 14: FAIR VALUE DISCLOSURES

The Company uses fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction occurring in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. In estimating fair value, the Company uses valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques refer to the assumptions used in pricing the asset or liability. Valuation inputs are categorized in a three-level hierarchy, that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 Inputs— Unadjusted quoted prices in active markets for identical assets and liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs— Other observable inputs that may include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active or other inputs that are observable for the asset or liability such as interest rates, volatilities, prepayment speeds, loss severities, credit risks and default rates or inputs that are observable or can be corroborated by observable market data.

Level 3 Inputs— Unobservable inputs that reflect an entity's own assumptions that market participants would use in pricing the assets or liabilities.

During the nine months ended September 30, 2019 and the year ended December 31, 2018, there were no transfers of assets or liabilities within the levels of the fair value hierarchy.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon models that primarily use observable market-based parameters as inputs. Valuation adjustments may be made to ensure that assets and liabilities are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time.

The Company's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value could result in different estimates of fair value. Fair value estimates are based on judgments regarding current economic conditions, risk characteristics of the various instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision.

Financial Instruments Measured at Fair Value on a Recurring Basis

The Company's assets and liabilities measured at fair value on a recurring basis include the following:

Debt Securities Available for Sale— Debt securities classified as available for sale are recorded at fair value. For those securities classified as Level 2, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S.

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Treasury yield curve, live trading levels, trade execution data, market consensus prepayments speeds, credit information and the security's terms and conditions, among other things. The Company reviews the prices supplied by the independent pricing service, as well as their underlying pricing methodologies for reasonableness. The other securities in the table below are mutual funds and the fair value is determined by using unadjusted quoted market prices which are considered Level 1 inputs.

Equity securities— Equity securities are classified as available for sale and are recorded at fair value. The fair value measurements are based on observable data obtained from a third-party pricing service. The Company reviews the prices supplied by the services against publicly available information. The equity securities are mutual funds publicly traded on the National Association of Securities Dealers Automated Quotations, or NASDAQ, and the fair value is determined by using unadjusted quoted market prices which are considered Level 1 inputs.

Interest Rate Swaps—The Company obtains fair value measurements for its interest rate swaps from an independent pricing service which uses the income approach. The income approach calls for the utilization of valuation techniques to convert future cash flows as due to be exchanged per the terms of the financial instrument, into a single present value amount. Measurement is based on the value indicated by the market expectations about those future amounts as of the measurement date. The proprietary curves of the independent pricing service utilize pricing models derived from industry standard analytic tools, considering both Level 1 and Level 2 inputs.

Financial assets and financial liabilities measured at fair value on a recurring basis as of the dates shown below were as follows:

(Dollars in thousands)	September 30, 2019	December 31, 2018
Fair value of financial assets:		
Level 1 inputs: securities available for sale - equity securities	\$ 1,146	\$ 1,088
Level 2 inputs:		
Debt securities available for sale		
State and municipal securities	53,094	57,691
U.S. Agency Securities:		
Debt securities	—	16,881
Collateralized mortgage obligations	61,339	65,414
Mortgage-backed securities	112,453	88,859
Interest rate swaps	3,758	962
Total fair value of financial assets	<u>\$ 231,790</u>	<u>\$ 230,895</u>
Fair value of financial liabilities:		
Level 2 inputs: interest rate swaps	\$ 3,758	\$ 962
Total fair value of financial liabilities	<u>\$ 3,758</u>	<u>\$ 962</u>

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Financial Instruments Measured at Fair Value on a Non-recurring Basis

A portion of financial instruments are measured at fair value on a non-recurring basis and are subject to fair value adjustments in certain circumstances. The Company's financial assets measured at fair value on a non-recurring basis are certain impaired loans and as of the dates shown below were as follows:

(Dollars in thousands)	September 30, 2019			December 31, 2018		
	Recorded Investment with Allowance	Related Allowance	Net	Recorded Investment with Allowance	Related Allowance	Net
Level 3 inputs						
Impaired loans:						
Commercial and industrial	\$ 454	\$ 373	\$ 81	\$ 635	\$ 525	\$ 110
Commercial real estate	574	22	552	596	44	552
1-4 family residential	1,786	33	1,753	1,824	89	1,735
Consumer	221	142	79	—	—	—
Other	1,241	22	1,219	1,241	100	1,141
Total impaired loans	\$ 4,276	\$ 592	\$ 3,684	\$ 4,296	\$ 758	\$ 3,538

Non-Financial Assets and Non-Financial Liabilities Measured on a Non-recurring Basis

The fair value portion of non-financial assets or non-financial liabilities is measured on a non-recurring basis in certain circumstances, such as when there is evidence of impairment and may be subject to impairment adjustments. The Company's non-financial assets whose fair value may be measured on a non-recurring basis include repossessed real estate, other foreclosed assets, goodwill and intangible assets, among other assets. There were no write-downs of foreclosed assets for fair value remeasurement subsequent to initial foreclosure during the nine months ended September 30, 2019 and during 2018, and there were no outstanding foreclosed assets as of September 30, 2019. The fair value of repossessed real estate and other foreclosed assets is estimated using Level 2 inputs and, as of the date shown below, were as follows:

(Dollars in thousands)	December 31, 2018
Foreclosed assets remeasured at initial recognition:	
Carrying value of foreclosed assets prior to measurement	\$ 13
Charge-offs recognized in the allowance for loan losses	(1)
Fair value	\$ 12

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Financial Instruments Reported at Amortized Cost

Fair market values and carrying amounts of financial instruments that are reported at cost as of the dates shown below were as follows:

(Dollars in thousands)	September 30, 2019		December 31, 2018	
	Fair Value	Carrying Amount	Fair Value	Carrying Amount
Financial assets:				
Level 1 inputs:				
Cash and due from banks	\$ 56,416	\$ 56,416	\$ 54,450	\$ 54,450
Interest bearing deposits in banks	232,983	232,983	327,620	327,620
Level 2 inputs:				
Debt securities held to maturity	31	29	32	31
Bank-owned life insurance	71,451	71,451	71,525	71,525
Accrued interest receivable	8,989	8,989	8,227	8,227
Servicing asset	151	151	166	166
Level 3 inputs:				
Loans, including held for sale, net	2,681,853	2,651,248	2,432,753	2,423,130
Other investments	19,220	19,220	13,026	13,026
Total financial assets	\$ 3,071,094	\$ 3,040,487	\$ 2,907,799	\$ 2,898,175
Financial liabilities:				
Level 1 inputs:				
Noninterest-bearing deposits	\$ 1,196,720	\$ 1,196,720	\$ 1,183,058	\$ 1,183,058
Level 2 inputs:				
Interest-bearing deposits	1,540,705	1,547,607	1,522,366	1,583,224
Repurchase agreements	1,206	1,208	2,498	2,498
Federal Home Loan Bank advances	118,782	120,000	—	—
Junior subordinated debt	—	—	1,571	1,571
Accrued interest payable	918	918	653	653
Total financial liabilities	\$ 2,858,331	\$ 2,866,453	\$ 2,710,146	\$ 2,771,004

The estimated fair value amounts of financial instruments have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret data to develop the estimates of fair value and as such the fair values shown above are not necessarily indicative of the amounts the Company will realize. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

NOTE 15: DERIVATIVE FINANCIAL INSTRUMENTS

The Company has outstanding interest rate swap contracts in which the Bank entered into an interest rate swap with a customer and entered into an offsetting interest rate swap with another financial institution at the same time. These interest rate swap contracts are not designated as hedging instruments for mitigating interest rate risk of the Bank. The objective of the transactions is to allow the Bank's customers to effectively convert a variable rate loan to a fixed rate.

In connection with each swap transaction, the Bank agrees to pay interest to the customer on a notional amount at a variable interest rate and receive interest from the customer on a similar notional amount at a fixed interest rate. At the same time, the Bank agrees to pay a third-party financial institution the same fixed interest rate on the same notional amount and receive the same variable interest rate on the same notional amount. Because the Bank acts as an intermediary for its customer, changes in the fair value of the underlying derivative contracts are designed to offset each other and would not significantly impact the Company's operating results except in certain situations where there is a significant deterioration in the customer's credit worthiness or that of the counterparties. At September 30, 2019 and December 31, 2018, no such deterioration was determined by management.

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At September 30, 2019 and December 31, 2018, the Company had 20 and 13 interest rate swap agreements outstanding with borrowers and financial institutions, respectively. These derivative instruments are not designated as accounting hedges and changes in the net fair value are recognized in noninterest income or expense. Fair value amounts are included in other assets and other liabilities. Interest rates on the Company's swap agreements are based on the London Interbank Offered Rate of the U.S. Dollar deposits in Europe, or LIBOR. Derivative instruments outstanding as of the dates shown below were as follows:

<u>(Dollars in thousands)</u>	<u>Classification</u>	<u>Notional Amounts</u>	<u>Fair Value</u>	<u>Fixed Rate</u>	<u>Floating Rate</u>	<u>Weighted Average Maturity (Years)</u>
September 30, 2019						
Interest rate swaps with customers	Other Assets	\$ 74,531	\$ 3,758	4.00% - 5.89%	LIBOR 1M + 2.50% - 3.25%	6.75
Interest rate swaps with financial institution	Other Liabilities	74,531	(3,758)	4.00% - 5.89%	LIBOR 1M + 2.50% - 3.25%	6.75
Total derivatives		<u>\$ 149,062</u>	<u>\$ —</u>			

<u>(Dollars in thousands)</u>	<u>Classification</u>	<u>Notional Amounts</u>	<u>Fair Value</u>	<u>Fixed Rate</u>	<u>Floating Rate</u>	<u>Weighted Average Maturity (Years)</u>
December 31, 2018						
Interest rate swaps with customers	Other Assets	\$ 8,901	\$ 169	5.45% - 7.25%	LIBOR 1M + 2.50% - 3.20%	6.22
Interest rate swaps with financial institution	Other Assets	32,923	793	4.00% - 5.37%	LIBOR 1M + 2.50% - 3.25%	7.78
Interest rate swaps with customers	Other Liabilities	32,923	(793)	4.00% - 5.37%	LIBOR 1M + 2.50% - 3.25%	7.78
Interest rate swaps with financial institution	Other Liabilities	8,901	(169)	5.45% - 7.25%	LIBOR 1M + 2.50% - 3.20%	6.22
Total derivatives		<u>\$ 83,648</u>	<u>\$ —</u>			

NOTE 16: OPERATING LEASES

The Company adopted Accounting Standards Update, or ASU 2016-02, Leases (Topic 842) on January 1, 2019 and the Company's leases within scope were operating leases of office space, stand-alone buildings and land. The Company's leases have no variable costs. Lease liabilities represent the Company's liability to make lease payments under these leases, on a discounted basis and at September 30, 2019, totaled \$15.5 million. The weighted-average discount rate for the nine months ended September 30, 2019 was 3.56%.

Right-of-use assets represent the Company's right to use, or control the use of, leased assets for their lease term and at September 30, 2019, totaled \$12.9 million. During the nine months ended September 30, 2019, the Company obtained \$838,000 of right-of-use assets in exchange for new operating lease liabilities related to two leases commenced in that period. The weighted-average remaining lease term for operating leases outstanding at September 30, 2019 was 11.4 years. Cash paid for amounts included in the measurement of operating lease liabilities for the nine months ended September 30, 2019 totaled \$1.4 million.

Lease costs for the period shown below were as follows:

<u>(Dollars in thousands)</u>	<u>Nine Months Ended September 30, 2019</u>
Operating lease cost	\$ 1,384
Short-term lease cost	54
Sublease income	(128)
Total lease cost	<u>\$ 1,310</u>

A maturity analysis of operating lease liabilities as of the date shown below was as follows:

<u>(Dollars in thousands)</u>	<u>September 30, 2019</u>
2019	\$ 498
2020	2,042
2021	2,108
2022	2,196
2023	2,105
Thereafter	10,954
Total undiscounted lease liability	<u>19,903</u>
Less:	
Discount on cash flows	(3,854)
Lease signed, but not yet commenced	(536)
Total operating lease liability	<u>\$ 15,513</u>

NOTE 17: COMMITMENTS AND CONTINGENCIES AND FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

Financial Instruments with Off-Balance-Sheet Risk

In the normal course of business, the Company enters into various transactions, which in accordance with GAAP are not included in its consolidated balance sheets. The Company enters into these transactions to meet the financing needs of its customers. These financial instruments include commitments to extend credit for loans in process and standby letters of credit. The Company uses the same credit policies in making these commitments and conditional obligations as it does for on-balance-sheet instruments.

Commitments to extend credit and standby letters of credit as of the dates shown below were as follows:

<u>(Dollars in thousands)</u>	<u>September 30,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
Commitments to extend credit, variable interest rate	\$ 662,364	\$ 726,277
Commitments to extend credit, fixed interest rate	121,527	105,359
	<u>\$ 783,891</u>	<u>\$ 831,636</u>
Standby letters of credit	<u>\$ 26,712</u>	<u>\$ 31,729</u>

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

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to the Company's customers.

Litigation

The Company is subject to claims and lawsuits which arise primarily in the ordinary course of business. Based on information presently available and advice received from legal counsel representing the Company, it is the opinion of management that the disposition or ultimate determination of such claims and lawsuits will not have a material adverse effect on the financial position or results of operations of the Company.

NOTE 18: REVENUE RECOGNITION

ASC 606 requires entities to recognize revenue in a way that depicts the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. A majority of the Company's revenue is derived from interest income on financial assets, which is not within the scope of ASC 606. Income from changes in the cash surrender value of bank-owned life insurance is also not within the scope of ASC 606.

The Company's revenue-generating activities that are within the scope of ASC 606 are included in noninterest income in the condensed consolidated income statements. The Company generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed and charged at a point in time based on activity.

(Dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Deposit account service charges	\$ 1,681	\$ 1,597	\$ 4,967	\$ 4,572
Net gain on sale of assets	190	152	347	492
Card interchange fees	908	922	2,713	2,820
Other noninterest income	906	412	2,303	1,150

NOTE 19: EMPLOYEE BENEFIT PLANS AND DEFERRED COMPENSATION ARRANGEMENTS*Employee Benefit Plans*

The Company maintains a 401(k) employee benefit plan and substantially all employees that complete three months of service may participate. The Company, at its discretion, may match a portion of each employee's contribution and may make additional contributions. For the nine months ended September 30, 2019 and 2018, the Company contributed \$1.5 million and \$1.4 million to the plan, respectively.

Executive Deferred Compensation Arrangements

The Company established an executive incentive compensation arrangement with several officers of the Bank, in which these officers are eligible for performance-based incentive bonus compensation. As part of this compensation arrangement, the Company contributes one-fourth of the incentive bonus amount into a deferred compensation account. The deferred amounts accrue at a market rate of interest and are payable to the employees upon separation from the Bank provided vesting arrangements have been met. At September 30, 2019 and December 31, 2018, the amount payable, including interest, for this deferred plan was approximately \$2.6 million and \$2.5 million, respectively, which is included in other liabilities in the condensed consolidated balance sheets.

Salary Continuation Agreements

The Company entered into a salary continuation arrangement in 2008 with the Company's then President and CEO that calls for payments of \$100,000 per year for a period of 10 years commencing at age 65. Payments under the plan began during 2014. The Company's liability was \$357,000 and \$421,000 at September 30, 2019 and December 31, 2018, respectively, which is included in other liabilities in the condensed consolidated balance sheets and equals the present value of the benefits expected to be provided.

In October 2017, the Company entered into a salary continuation arrangement with the Company's President and CEO that calls for payments of \$200,000 per year payable for a period of 10 years commencing at age 70. Payments under the plan will begin in 2024. The Company's liability was \$382,000 and \$219,000 at September 30, 2019 and December 31, 2018, respectively, which is included in other liabilities in the condensed consolidated balance sheets. The liability will continue to accrue over the remaining period until payments commence such that the accrued amount at the eligibility date will equal the present value of all the future benefits expected to be paid.

Change of Control Agreements

In 2017, the Company entered into employment agreements with certain executive officers. These agreements provide for severance benefits if the Company terminates the executive without cause or the executive resigns with good reason, as defined in the agreements. In addition, upon a change of control, as that term is defined in the agreements, these employees will be entitled to an aggregate amount estimated to be \$4.4 million at September 30, 2019 and December 31, 2018, in accordance to the terms of their respective agreements. No compensation has been recorded to date as a change of control condition is not deemed probable.

NOTE 20: STOCK-BASED COMPENSATION

The Company acquired a stock option plan which originated under VB Texas, Inc. as a part of a merger of the two companies. The options granted to employees must be exercised within 10 years from the date of grant and vesting schedules are determined on an individual basis. At the merger date, all outstanding options became fully vested and were converted to options of the Company's common stock at an exchange ratio equal to the acquisition exchange rate for common shares. No options were granted under this plan after October 24, 2016.

In May 2014, the Company adopted the 2014 Stock Option Plan, or the 2014 Plan. The 2014 Plan was approved by the Company's shareholders and limits the number of shares that may be optioned to 1,127,200. The 2014 Plan provides that no options may be granted after May 20, 2024. Options granted under the 2014 Plan expire 10 years from the date of grant and become exercisable in installments over a period of one to five years, beginning on the first anniversary of the date of grant. At September 30, 2019, 963,200 shares were available for future grant under the 2014 Plan.

In September 2017, the Company adopted the 2017 Omnibus Incentive Plan, or the 2017 Plan. The 2017 Plan authorizes the Company to grant options and performance-based and non-performance based restricted stock awards as well as various other types of stock-based and other awards that are not stock-based to eligible employees, consultants and non-employee directors up to an aggregate of 600,000 shares of common stock. At September 30, 2019, 314,924 shares were available for future grant under the 2017 Plan.

Stock option activity for the periods shown below was as follows:

	Nine Months Ended September 30,			
	2019		2018	
	Number of Shares Underlying Options	Weighted Average Exercise Price	Number of Shares Underlying Options	Weighted Average Exercise Price
Outstanding at beginning of period	232,322	\$ 16.66	260,322	\$ 16.00
Granted	—	—	—	—
Exercised	(15,244)	12.74	(25,400)	9.85
Forfeited/expired	(4,000)	17.73	—	—
Outstanding at end of period	213,078	16.92	234,922	16.67

A summary of stock options as of the dates shown below was as follows:

Stock Options	September 30, 2019		
	Exercisable	Unvested	Outstanding
Number of shares underlying options	148,879	64,199	213,078
Weighted-average exercise price per share	\$ 15.62	\$ 19.94	\$ 16.92
Aggregate intrinsic value (in thousands)	\$ 1,871	\$ 530	\$ 2,401
Weighted-average remaining contractual term (years)	5.1	7.2	5.7

The fair value of the Company's restricted stock awards is estimated based on the market value of the Company's common stock at the date of grant. Restricted stock shares are considered fully issued at the time of the grant and the grantee becomes the record owner of the restricted stock and has voting, dividend and other shareholder rights. The shares

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of restricted stock are non-transferable and subject to forfeiture until the restricted stock vests and any dividends with respect to the restricted stock are subject to the same restrictions, including the risk of forfeiture.

Non-performance based restricted stock grants vest over the service period in equal increments over a period of two to five years, beginning on the first anniversary of the date of grant.

The number of shares earned under the Company's performance-based restricted stock award agreements is based on the achievement of certain branch production goals. Compensation expense for performance-based restricted stock is recognized for the probable award level over the period estimated to achieve the performance conditions and other goals, on a straight-line basis. If the probable award level and/or the period estimated to be achieved change, compensation expense will be adjusted via a cumulative catch-up adjustment to reflect these changes. The performance conditions goals must be achieved within five years or the awards expire. The number of performance-based shares granted presented in the table below is based upon the attainment of the maximum number of shares possible to be earned.

Restricted stock activity for the periods shown below was as follows:

	Non-performance Based		Performance-based	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2017	212,580	\$ 26.71	—	\$ —
Granted	18,500	29.71	—	—
Vested	—	—	—	—
Forfeited	—	—	—	—
Outstanding at September 30, 2018	231,080	\$ 26.95	—	\$ —
Outstanding at December 31, 2018	181,773	27.05	24,000	34.46
Granted	36,992	32.18	—	—
Vested	(3,100)	29.69	—	—
Forfeited	(3,220)	29.99	—	—
Outstanding at September 30, 2019	212,445	\$ 27.86	24,000	\$ 34.46

A summary of restricted stock as of the dates shown below was as follows:

Restricted Stock	September 30, 2019	
	Non-performance Based	Performance-based
Number of shares underlying restricted stock	212,445	24,000
Weighted-average grant date fair value per share	\$ 27.86	\$ 34.46
Aggregate fair value (in thousands)	\$ 5,923	\$ 677
Weighted-average remaining vesting period (years)	2.9	2.4

The Company's stock compensation plans allow employees to elect to have shares withheld to satisfy their tax liabilities related to options exercised or restricted stock vested or to pay the exercise price of the options. During the periods shown below, the shares of stock options exercised and restricted stock vested, shares withheld and shares issued were as follows:

	Three Months Ended September 30, 2019		
	Exercised/Vested	Shares Withheld	Shares Issued
Stock Options	400	(280)	120
Restricted Stock	—	—	—
	Nine Months Ended September 30, 2019		
	Exercised/Vested	Shares Withheld	Shares Issued
Stock Options	15,244	(2,318)	12,926
Restricted Stock	3,100	(658)	2,442

There were no shares withheld for options exercised or restricted stock vested in the nine months ended September 30, 2018.

For the three and nine months ended September 30, 2019 and 2018, stock compensation expense was \$608,000, \$415,000, \$1.7 million and \$1.2 million, respectively. As of September 30, 2019, there was approximately \$5.4 million of total unrecognized compensation expense related to the stock-based compensation arrangements, which is expected to be recognized in the Company's consolidated statements of income over a weighted-average period of 2.8 years.

NOTE 21: REGULATORY MATTERS

Banks and bank holding companies are subject to various regulatory capital requirements administered by state and federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weighting and other factors.

The Company and the Bank's Common Equity Tier 1 capital includes common stock and related capital surplus, net of treasury stock, and retained earnings. In connection with the adoption of the Basel III Capital Rules, the Company and the Bank elected to opt-out of the requirement to include most components of accumulated other comprehensive income in Common Equity Tier 1. Common Equity Tier 1 for both the Company and the Bank is reduced by goodwill and other intangible assets, net of associated deferred tax liabilities, and subject to transition provisions.

The Basel III Capital Rules require the Company and the Bank to maintain (i) a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% Common Equity Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of at least 7.0% upon full implementation), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of Total capital (that is, Tier 1 plus Tier 2) to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation) and (iv) a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to average quarterly assets.

The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and was phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reached 2.5% on January 1, 2019). The Basel III Capital Rules also provide for a "countercyclical capital buffer" that is applicable to only certain covered institutions and does not have any current applicability to the Company and the Bank. The capital conservation buffer is designed to absorb losses during periods of economic stress and, as detailed above, effectively increases the minimum required risk-weighted capital ratios. Banking institutions with a ratio of Common Equity Tier 1 capital to risk-weighted assets below the effective minimum (4.5% plus the capital conservation buffer and, if applicable, the countercyclical capital buffer) will face constraints on dividends, equity repurchases, and compensation based on the amount of the shortfall.

The Company and the Bank are subject to the regulatory capital requirements administered by the Federal Reserve and, for the Bank, the OCC. Regulatory authorities can initiate certain mandatory actions if the Company or the Bank fail to meet the minimum capital requirements, which could have a direct material effect on the Company's financial statements. Management believes, as of September 30, 2019 and December 31, 2018, that the Company and the Bank met all capital adequacy requirements to which they were subject.

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As of September 30, 2019 and December 31, 2018, the Company and the Bank, were “well capitalized” based on the ratios presented below. Actual and required capital ratios for the Company and the Bank were as follows for the dates presented:

(Dollars in thousands)	Actual		Minimum Capital Required for Capital Adequacy Purposes		Minimum Capital Required Basel III Fully Phased-in		Required to be Considered Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2019								
Common Equity Tier I to Risk-Weighted Assets:								
Consolidated	\$ 437,738	14.99%	\$ 131,426	4.50%	\$ 204,440	7.00%	N/A	N/A
Bank Only	\$ 396,161	13.57%	\$ 131,415	4.50%	\$ 204,424	7.00%	\$ 189,822	6.50%
Tier I Capital to Risk-Weighted Assets:								
Consolidated	\$ 437,738	14.99%	\$ 175,234	6.00%	\$ 248,248	8.50%	N/A	N/A
Bank Only	\$ 396,161	13.57%	\$ 175,220	6.00%	\$ 248,229	8.50%	\$ 233,627	8.00%
Total Capital to Risk-Weighted Assets:								
Consolidated	\$ 463,692	15.88%	\$ 233,646	8.00%	\$ 306,660	10.50%	N/A	N/A
Bank Only	\$ 422,115	14.45%	\$ 233,627	8.00%	\$ 306,635	10.50%	\$ 292,034	10.00%
Tier I Leverage Capital to Average Assets:								
Consolidated	\$ 437,738	13.23%	\$ 132,358	4.00%	\$ 132,358	4.00%	N/A	N/A
Bank Only	\$ 396,161	11.97%	\$ 132,344	4.00%	\$ 132,344	4.00%	\$ 165,430	5.00%
December 31, 2018								
Common Equity Tier I to Risk-Weighted Assets:								
Consolidated	\$ 405,012	14.71%	\$ 123,885	4.50%	\$ 192,710	7.00%	N/A	N/A
Bank Only	\$ 363,140	13.19%	\$ 123,877	4.50%	\$ 192,697	7.00%	\$ 178,933	6.50%
Tier I Capital to Risk-Weighted Assets:								
Consolidated	\$ 406,257	14.76%	\$ 165,180	6.00%	\$ 234,005	8.50%	N/A	N/A
Bank Only	\$ 363,140	13.19%	\$ 165,169	6.00%	\$ 233,989	8.50%	\$ 220,225	8.00%
Total Capital to Risk-Weighted Assets:								
Consolidated	\$ 430,238	15.63%	\$ 220,240	8.00%	\$ 289,065	10.50%	N/A	N/A
Bank Only	\$ 387,211	14.07%	\$ 220,225	8.00%	\$ 289,046	10.50%	\$ 275,282	10.00%
Tier I Leverage Capital to Average Assets:								
Consolidated	\$ 406,257	12.74%	\$ 127,350	4.00%	\$ 127,350	4.00%	N/A	N/A
Bank Only	\$ 363,140	11.41%	\$ 127,350	4.00%	\$ 127,350	4.00%	\$ 159,188	5.00%

Dividend Restrictions

In the ordinary course of business, the Company may be dependent upon dividends from the Bank to provide funds for the payment of dividends to shareholders and to provide for other cash requirements. Banking regulations may limit the amount of dividends that may be paid. Approval by regulatory authorities is required if the effect of dividends declared would cause the regulatory capital of the Bank to fall below specified minimum levels. Approval is also required if dividends declared exceed the net profits for that year combined with the retained net profits for the preceding two years.

NOTE 22: INCOME TAXES

The provision for income tax expense and effective tax rates for the periods shown below were as follows:

(Dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Provision for income tax expense	\$ 2,990	\$ 3,207	\$ 8,666	\$ 7,984
Effective tax rate	18.61%	19.76%	18.62%	19.40%

The differences between the federal statutory rate of 21% and the effective tax rates presented in the table above were largely attributable to permanent differences primarily related to tax exempt interest income and bank-owned life insurance related earnings.

NOTE 23: EARNINGS PER SHARE

The computation of basic and diluted earnings per share for the periods shown was as follows:

(Dollars in thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Net income for common shareholders	\$ 13,076	\$ 13,023	\$ 37,881	\$ 33,177
Weighted-average shares (thousands)				
Basic weighted-average shares outstanding	24,923	24,859	24,918	24,850
Dilutive effect of outstanding stock options and unvested restricted stock awards	123	201	135	157
Diluted weighted-average shares outstanding	25,046	25,060	25,053	25,007
Earnings per share:				
Basic	\$ 0.52	\$ 0.52	\$ 1.52	\$ 1.34
Diluted	\$ 0.52	\$ 0.52	\$ 1.51	\$ 1.33

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements. These forward-looking statements reflect our current views with respect to, among other things, future events and our financial performance. These statements are often, but not always, made through the use of words or phrases such as "may," "should," "could," "predict," "potential," "believe," "will likely result," "expect," "continue," "will," "anticipate," "seek," "estimate," "intend," "plan," "projection," "would" and "outlook," or the negative version of those words or other comparable words or phrases of a future or forward-looking nature. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about our industry, management's beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. Accordingly, we caution you that any such forward-looking statements are not guarantees of future performance and are subject to risks, assumptions and uncertainties that are difficult to predict. Although we believe that the expectations reflected in these forward-looking statements are reasonable as of the date made, actual results may prove to be materially different from the results expressed or implied by the forward-looking statements.

There are or will be important factors that could cause our actual results to differ materially from those indicated in these forward-looking statements, including, but not limited to, the risks described in Part I — Item 1A. — Risk Factors in our Annual Report on Form 10-K and the following:

- natural disasters and adverse weather (including the effects of recent hurricanes, tropical storms and tropical depressions on our market area), acts of terrorism, an outbreak of hostilities or other international or domestic calamities and other matters beyond our control;
- the geographic concentration of our markets in Beaumont and Houston, Texas;
- our ability to prudently manage our growth and execute our strategy;
- risks associated with our acquisition and *de novo* branching strategy, including our entry into new markets;
- changes in management personnel;
- the amount of nonperforming and classified assets that we hold and the time and effort necessary to resolve nonperforming assets;
- deterioration of our asset quality;
- interest rate risk associated with our business;
- business and economic conditions generally and in the financial services industry, nationally and within our primary markets;
- volatility and direction of oil prices and the strength of the energy industry, generally and within Texas;
- the composition of our loan portfolio, including the identity of our borrowers and the concentration of loans in specialized industries;
- changes in the value of collateral securing our loans;
- our ability to maintain important deposit customer relationships and our reputation;
- our ability to maintain effective internal control over financial reporting;
- increased competition in the financial services industry, particularly from regional and national institutions;
- volatility and direction of market interest rates;
- liquidity risks associated with our business;
- systems failures or interruptions involving our information technology and telecommunications systems or third-party servicers;
- interruptions or breaches in our information system security;
- the failure of certain third-party vendors to perform;
- environmental liability associated with our lending activities;
- the institution and outcome of litigation and other legal proceedings against us or to which we may become subject;

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- the costs and effects of regulatory or other governmental inquiries, the results of regulatory examinations, investigations, or reviews or the ability to obtain required regulatory approvals;
- changes in the laws, rules, regulations, interpretations or policies relating to financial institution, accounting, tax, trade, monetary and fiscal matters;
- further government intervention in the U.S. financial system;
- other risks, uncertainties, and factors that are discussed from time to time in our reports and documents filed with the SEC; and
- other factors that are discussed in the section to this Quarterly Report on Form 10-Q entitled “Risk Factors”.

The foregoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included in this Quarterly Report on Form 10-Q. If one or more events related to these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may differ materially from what we anticipate. Accordingly, you should not place undue reliance on any such forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made, and we do not undertake any obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise. New factors emerge from time to time, and it is not possible for us to predict which will arise. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and the accompanying notes included in Item I of Part I of this Quarterly Report on Form 10-Q, as well as our consolidated financial statements and the accompanying notes for the year ended December 31, 2018, included in our Annual Report on Form 10-K. In this Quarterly Report on Form 10-Q, unless otherwise indicated or the context otherwise requires, all references to “we,” “our,” “us,” “ourselves,” and “the Company” refer to CBTX, Inc., a Texas corporation, and its consolidated subsidiary. All references in this Quarterly Report on Form 10-Q to “CommunityBank of Texas” or “the Bank” refer to CommunityBank of Texas, N.A., our wholly-owned bank subsidiary.

Overview

We operate through one segment, community banking. Our primary source of funds is deposits and our primary use of funds is loans. Most of our revenue is generated from interest on loans and investments. We incur interest expense on deposits and other borrowed funds as well as noninterest expense, such as salaries and employee benefits and occupancy expenses.

Our operating results depend primarily on our net interest income, calculated as the difference between interest income on interest-earning assets, such as loans and securities, and interest expense on interest-bearing liabilities, such as deposits and borrowings. Changes in market interest rates and the interest rates we earn on interest-earning assets or pay on interest-bearing liabilities, as well as in the volume and types of interest-earning asset and interest-bearing liabilities, are usually the largest drivers of periodic changes in net interest spread, net interest margin and net interest income. Fluctuations in market interest rates are driven by many factors, including governmental monetary policies, inflation, deflation, macroeconomic developments, changes in unemployment, the money supply, political and international conditions and conditions in domestic and foreign financial markets.

Periodic changes in the volume and types of loans in our loan portfolio are affected by, among other factors, economic and competitive conditions in Texas, as well as developments affecting the real estate, technology, financial services, insurance, transportation, manufacturing and energy sectors within our target markets and throughout the state of Texas. We maintain diversity in our loan portfolio as a means of managing risk associated with fluctuations in economic conditions. Our focus on lending to small to medium-sized businesses and professionals in our market areas has resulted in a diverse loan portfolio comprised primarily of core relationships. We carefully monitor exposure to certain asset classes to minimize the impact of a downturn in the value of such assets.

We seek to remain competitive with respect to interest rates on loans and deposits, as well as prices on fee-based services, which are typically significant competitive factors within the banking and financial services industry. Many of our competitors are much larger financial institutions that have greater financial resources than we do and compete

aggressively for market share. Through our relationship-driven, community banking strategy, a significant portion of our continued growth has been through referral business from our existing customers and professionals in our markets including attorneys, accountants and other professional service providers.

The Bank is the subject of an investigation by the Financial Crimes Enforcement Network, or FinCEN, of the U.S. Department of the Treasury regarding the Bank's compliance with the Bank Secrecy Act and anti-money laundering laws and regulations. The Bank is cooperating with this investigation. The costs to respond to and cooperate with FinCEN's investigation have been material over the course of the period of this report, and the Bank expects to continue to incur material fees and expenses regarding this matter at least through the completion of FinCEN's investigation.

Results of Operations

Net income for the three and nine months ended September 30, 2019 increased 0.4% and 14.2%, respectively, compared to the three and nine months ended September 30, 2018. These increases are primarily due to increased net interest income and noninterest income, partially offset by higher noninterest expense. See further analysis of these fluctuations in the related discussions that follow.

(Dollars in thousands, except per share data and percentages)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2019	2018	Increase (Decrease)		2019	2018	Increase (Decrease)	
Interest income	\$ 39,193	\$ 34,665	\$ 4,528	13.1%	\$ 114,827	\$ 98,877	\$ 15,950	16.1%
Interest expense	4,618	3,139	1,479	47.1%	12,625	7,436	5,189	69.8%
Net interest income	34,575	31,526	3,049	9.7%	102,202	91,441	10,761	11.8%
Provision for loan losses	579	(1,142)	1,721	150.7%	2,533	413	2,120	513.3%
Noninterest income	4,115	3,526	589	16.7%	14,911	10,393	4,518	43.5%
Noninterest expense	22,045	19,964	2,081	10.4%	68,033	60,260	7,773	12.9%
Income before income taxes	16,066	16,230	(164)	(1.0%)	46,547	41,161	5,386	13.1%
Income tax expense	2,990	3,207	(217)	(6.8%)	8,666	7,984	682	8.5%
Net income	\$ 13,076	\$ 13,023	\$ 53	0.4%	\$ 37,881	\$ 33,177	\$ 4,704	14.2%
Earnings per share - basic	\$ 0.52	0.52			\$ 1.52	\$ 1.34		
Earnings per share - diluted	\$ 0.52	0.52			\$ 1.51	\$ 1.33		
Dividends declared per share	\$ 0.10	0.05			\$ 0.30	0.15		
Dividend payout ratio	19.25%	9.64%			19.92%	11.34%		
Return on average assets ⁽¹⁾	1.53%	1.62%			1.52%	1.42%		
Return on average shareholders' equity ⁽¹⁾	9.92%	11.02%			9.95%	9.65%		
Efficiency ratio ⁽²⁾	56.98%	56.96%			58.09%	59.17%		

(1) Annualized.

(2) Efficiency ratio represents noninterest expense divided by the sum of net interest income and noninterest income.

Net Interest Income for the Nine Months Ended September 30, 2019 Compared to the Nine Months Ended September 30, 2018.

Net interest income for the nine months ended September 30, 2019 was \$102.2 million, compared to \$91.4 million for the nine months ended September 30, 2018, an increase of \$10.8 million, or 11.8%. The increase in net interest income in the nine months of 2019, compared to the nine months of 2018 was primarily due to higher average loans, higher average yields on loans and higher average yields on other interest-earning assets, partially offset by the impact of higher average rates on interest-bearing deposits and higher average FHLB advances. Average loans increased in the first nine months of 2019 due to organic growth and the increase in average loan yields reflects rates in the market. The increase in average rates on interest-bearing deposits in the first nine months of 2019 was mainly due to competitive stress on rates primarily for certificates of deposit and

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money market accounts. Although rates have increased on the Company's interest-bearing deposits, they remain a low-cost source of funds compared to other sources such as debt.

The following table presents for the periods indicated, average outstanding balances for each major category of interest-earning assets and interest-bearing liabilities, the interest income or interest expense and the average yield or rate for the periods indicated.

(Dollars in thousands)	Nine Months Ended September 30,					
	2019			2018		
	Average Outstanding Balance	Interest Earned/ Interest Paid	Average Yield/ Rate ⁽¹⁾	Average Outstanding Balance	Interest Earned/ Interest Paid	Average Yield/ Rate ⁽¹⁾
Assets						
Interest-earnings assets:						
Total loans ⁽²⁾	\$ 2,583,454	\$ 105,754	5.47%	\$ 2,366,714	\$ 90,468	5.11%
Securities	233,913	4,512	2.58%	227,552	4,478	2.63%
Other interest-earning assets	224,123	4,054	2.42%	242,529	3,334	1.84%
Equity investments	14,419	507	4.70%	15,449	597	5.17%
Total interest-earning assets	3,055,909	\$ 114,827	5.02%	2,852,244	\$ 98,877	4.63%
Allowance for loan losses	(24,762)			(25,318)		
Noninterest-earnings assets	299,648			289,391		
Total assets	\$ 3,330,795			\$ 3,116,317		
Liabilities and Shareholders' Equity						
Interest-bearing liabilities:						
Interest-bearing deposits	\$ 1,538,793	\$ 11,536	1.00%	\$ 1,499,925	\$ 7,035	0.63%
FHLB advances and repurchase agreements	60,377	1,073	2.38%	5,979	76	1.70%
Note payable and junior subordinated debt	—	16	—	10,826	325	4.01%
Total interest-bearing liabilities	1,599,170	\$ 12,625	1.06%	1,516,730	\$ 7,436	0.66%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	1,186,985			1,118,408		
Other liabilities	35,791			21,744		
Total noninterest-bearing liabilities	1,222,776			1,140,152		
Shareholders' equity	508,849			459,435		
Total liabilities and shareholders' equity	\$ 3,330,795			\$ 3,116,317		
Net interest income		\$ 102,202			\$ 91,441	
Net interest spread ⁽³⁾			3.96%			3.97%
Net interest margin ⁽⁴⁾			4.47%			4.29%
Net interest margin—tax equivalent ⁽⁵⁾			4.51%			4.32%

(1) Annualized.

(2) Includes average outstanding balances related to loans held for sale.

(3) Net interest spread is the average yield on interest-earning assets minus the average rate on interest-bearing liabilities.

(4) Net interest margin is equal to net interest income divided by average interest-earning assets.

(5) Tax equivalent adjustments of \$770,000 and \$798,000 for the nine months ended September 30, 2019 and 2018, respectively, were computed using a federal income tax rate of 21%.

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The following tables present information regarding changes in interest income and interest expense for the periods indicated for each major component of interest-earning assets and interest-bearing liabilities and distinguishes between the changes attributable to changes in volume and changes attributable to changes in interest rates. For purposes of these tables, changes attributable to both rate and volume that cannot be segregated have been allocated to rate.

(Dollars in thousands)	Nine Months Ended September 30, 2019, Compared to Nine Months Ended September 30, 2018		
	Increase (Decrease) due to		
	Volume	Rate	Total
Interest-earning assets:			
Total loans	\$ 8,285	\$ 7,001	\$ 15,286
Securities	125	(91)	34
Other interest-earning assets	(253)	973	720
Equity investments	(40)	(50)	(90)
Total increase in interest income	8,117	7,833	15,950
Interest-bearing liabilities:			
Interest-bearing deposits	182	4,319	4,501
FHLB advances and repurchase agreements	889	108	997
Note payable and junior subordinated debt	(314)	5	(309)
Total increase in interest expense	757	4,432	5,189
Increase in net interest income	\$ 7,360	\$ 3,401	\$ 10,761

Net Interest Income for the Three Months Ended September 30, 2019 Compared to the Three Months Ended September 30, 2018.

Net interest income for the three months ended September 30, 2019 was \$34.6 million, compared to \$31.5 million for the three months ended September 30, 2018, an increase of \$3.0 million, or 9.7%. The increase in net interest income between these periods was primarily due to higher average loan balances and average yields, partially offset by the impact of higher average rates on interest-bearing deposits and increased average FHLB advances.

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The following table presents for the periods indicated, average outstanding balances for each major category of interest-earning assets and interest-bearing liabilities, the interest income or interest expense and the average yield or rate for the periods indicated.

(Dollars in thousands)	Three Months Ended September 30,					
	2019			2018		
	Average Outstanding Balance	Interest Earned/Interest Paid	Average Yield/Rate ⁽¹⁾	Average Outstanding Balance	Interest Earned/Interest Paid	Average Yield/Rate
Assets						
Interest-earnings assets:						
Total loans ⁽²⁾	\$ 2,655,941	\$ 36,353	5.43%	\$ 2,404,491	\$ 31,513	5.20%
Securities	234,525	1,436	2.41%	230,592	1,535	2.64%
Other interest-earning assets	215,900	1,212	2.25%	272,739	1,404	2.04%
Equity investments	16,154	192	4.72%	16,799	213	5.01%
Total interest-earning assets	3,122,520	\$ 39,193	4.98%	2,924,621	\$ 34,665	4.70%
Allowance for loan losses	(25,422)			(25,689)		
Noninterest-earnings assets	296,861			292,598		
Total assets	\$ 3,393,959			\$ 3,191,530		
Liabilities and Shareholders' Equity						
Interest-bearing liabilities:						
Interest-bearing deposits	\$ 1,557,503	\$ 4,130	1.05%	\$ 1,530,077	\$ 2,961	0.77%
FHLB advances and repurchase agreements	84,847	484	2.26%	12,657	62	1.94%
Note payable and junior subordinated debt	—	4	—	10,826	116	4.25%
Total interest-bearing liabilities	1,642,350	\$ 4,618	1.12%	1,553,560	\$ 3,139	0.80%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	1,189,087			1,145,516		
Other liabilities	39,775			23,600		
Total noninterest-bearing liabilities	1,228,862			1,169,116		
Shareholders' equity	522,747			468,854		
Total liabilities and shareholders' equity	\$ 3,393,959			\$ 3,191,530		
Net interest income		\$ 34,575			\$ 31,526	
Net interest spread ⁽³⁾			3.86%			3.90%
Net interest margin ⁽⁴⁾			4.39%			4.28%
Net interest margin—tax equivalent ⁽⁵⁾			4.43%			4.31%

(1) Annualized.

(2) Includes average outstanding balances related to loans held for sale.

(3) Net interest spread is the average yield on interest-earning assets minus the average rate on interest-bearing liabilities.

(4) Net interest margin is equal to net interest income divided by average interest-earning assets.

(5) Tax equivalent adjustments of \$257,000 and \$261,000 for the three months ended September 30, 2019 and 2018, respectively, were computed using a federal income tax rate of 21%.

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The following tables present information regarding changes in interest income and interest expense for the periods indicated for each major component of interest-earning assets and interest-bearing liabilities and distinguishes between the changes attributable to changes in volume and changes attributable to changes in interest rates. For purposes of these tables, changes attributable to both rate and volume that cannot be segregated have been allocated to rate.

(Dollars in thousands)	Three Months Ended September 30, 2019, Compared to Three Months Ended September 30, 2018		
	Increase (Decrease) due to		
	Volume	Rate	Total
Interest-earning assets:			
Total loans	\$ 3,295	\$ 1,545	\$ 4,840
Securities	26	(125)	(99)
Other interest-earning assets	(293)	101	(192)
Equity investments	(8)	(13)	(21)
Total increase in interest income	3,020	1,508	4,528
Interest-bearing liabilities:			
Interest-bearing deposits	53	1,116	1,169
FHLB advances and repurchase agreements	398	24	422
Note payable and junior subordinated debt	(112)	—	(112)
Total increase in interest expense	339	1,140	1,479
Increase in net interest income	\$ 2,681	\$ 368	\$ 3,049

Provision for Loan Losses

The provision for loan losses is an expense used to maintain an allowance for loan losses at a level which is deemed appropriate by management to absorb inherent losses on existing loans. The provision for loan losses increased \$2.1 million to \$2.5 million for the nine months ended September 30, 2019, compared to \$413,000 for the nine months ended September 30, 2018, reflecting the increase in loans during those periods.

The provision for loan losses for the three months ended September 30, 2019 was \$579,000 compared to a recapture of \$1.1 million for the three months ended September 30, 2018. The increase in the provision for loan losses between these periods of \$1.7 million reflects the increase in loans during those periods.

Noninterest Income

For the nine months ended September 30, 2019, noninterest income increased \$4.5 million, compared to the nine months ended September 30, 2018, primarily due to increased earnings on bank-owned life insurance. For the three months ended September 30, 2019, noninterest income increased \$589,000, compared to the three months ended September 30, 2018, primarily due to increased swap origination fees. See further analysis of these fluctuations in the related discussions that follow.

(Dollars in thousands)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2019	2018	Increase (Decrease)		2019	2018	Increase (Decrease)	
Deposit account service charges	\$ 1,681	\$ 1,597	\$ 84	5.3%	\$ 4,967	\$ 4,572	\$ 395	8.6%
Net gain on sale of assets	190	152	38	25.0%	347	492	(145)	(29.5%)
Card interchange fees	908	922	(14)	(1.5%)	2,713	2,820	(107)	(3.8%)
Earnings on bank-owned life insurance	430	443	(13)	(2.9%)	4,581	1,359	3,222	237.1%
Other	906	412	494	119.9%	2,303	1,150	1,153	100.3%
Total noninterest income	\$ 4,115	\$ 3,526	\$ 589	16.7%	\$ 14,911	\$ 10,393	\$ 4,518	43.5%

Deposit Account Service Charges. Service charges on deposit accounts increased in the nine months ended September 30, 2019, compared to the same period in 2018, predominately due to an increase in non-sufficient and account analysis charges incurred by the Company's deposit customers.

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Net Gain on Sale of Assets. Net gain on sale of assets consists of the gains associated with the sale of fixed assets, loans, securities and other real estate owned, or OREO. Net gain on sale of assets decreased in the nine months ended September 30, 2019, compared to the same period in 2018, primarily due to lower gains on sales of loans held for sale during the 2019.

Earnings on Bank-Owned Life Insurance. The Company has purchased life insurance policies on certain employees, that are carried at their cash surrender value on the condensed consolidated balance sheet and changes in the cash surrender value of the policies are recorded in noninterest income. Earnings on bank-owned life insurance increased \$3.2 million, during the nine months ended September 30, 2019, compared to the same period of 2018 due to nontaxable death benefit proceeds of \$4.7 million received under bank-owned insurance policies. The Company recorded a gain of \$3.3 million over the cash surrender value during the nine months ended September 30, 2019.

Other. This category includes a variety of other income-producing activities, including partnership and investment fund income, other loan fees, swap origination charges, wire transfer fees, credit card program income and other fee income. Other noninterest income increased during the three and nine months ended September 30, 2019, compared to the same periods of the prior year due to increased swap origination fees.

Noninterest Expense

Generally, noninterest expense is composed of employee expenses and costs associated with operating facilities, obtaining and retaining customer relationships and providing bank services. For the three and nine months ended September 30, 2019, compared to the same period of the prior year, noninterest expense increased primarily due to increased salaries and employee benefits and professional and director fees. See further analysis of these fluctuations in the related discussions that follow.

(Dollars in thousands)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2019	2018	Increase (Decrease)		2019	2018	Increase (Decrease)	
	\$	\$						
Salaries and employee benefits	13,951	12,499	\$ 1,452	11.6%	\$ 41,958	\$ 37,690	\$ 4,268	11.3%
Net occupancy expense	2,484	2,428	56	2.3%	7,089	7,126	(37)	(0.5%)
Regulatory fees	144	488	(344)	(70.5%)	1,054	1,546	(492)	(31.8%)
Data processing	652	664	(12)	(1.8%)	2,027	2,013	14	0.7%
Software	469	400	69	17.3%	1,334	1,168	166	14.2%
Printing, stationery and office	313	291	22	7.6%	993	858	135	15.7%
Amortization of intangibles	221	245	(24)	(9.8%)	678	748	(70)	(9.4%)
Professional and director fees	1,455	809	646	79.9%	5,828	2,414	3,414	141.4%
Correspondent bank and customer related expense	67	66	1	1.5%	198	201	(3)	(1.5%)
Loan processing	124	102	22	21.6%	343	295	48	16.3%
Advertising, marketing and business development	407	437	(30)	(6.9%)	1,379	1,418	(39)	(2.8%)
Repossessed real estate and other assets	—	3	(3)	(100.0%)	—	65	(65)	(100.0%)
Security and protection expense	410	346	64	18.5%	1,100	959	141	14.7%
Telephone and communications	434	342	92	26.9%	1,268	1,122	146	13.0%
Other expense	914	844	70	8.3%	2,784	2,637	147	5.6%
	\$	\$						
Total noninterest expense	<u>22,045</u>	<u>19,964</u>	<u>\$ 2,081</u>	10.4%	<u>\$ 68,033</u>	<u>\$ 60,260</u>	<u>\$ 7,773</u>	12.9%

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Salaries and Employee Benefits. Salaries and benefits increased in the three and nine months ended September 30, 2019, compared to the same periods in the prior year as a result of annual salary increases in 2019, increased headcount and increased stock compensation expense due to restricted stock grants.

Regulatory Fees. Regulatory fees decreased in the three and nine months ended September 30, 2019, compared to the same periods in the prior year due to an FDIC deposit assessment credit received.

Professional and Director Fees. Professional and director fees include legal, audit, loan review and consulting fees. The increase during the three and nine months ended September 30, 2019, compared to the same periods in 2018, is primarily due to increased legal fees incurred in the Bank's responding and cooperating with an investigation by FinCEN regarding the Bank's compliance with the Bank Secrecy Act and anti-money laundering laws and regulations. The Bank incurred legal fees related to this investigation of \$729,000 and \$3.3 million in the three and nine months ended September 30, 2019, respectively.

Income Tax Expense

The amount of income tax expense is impacted by the amounts of pre-tax income, tax-exempt income and other nondeductible expenses. Deferred tax assets and liabilities are reflected at current income tax rates in effect for the period in which the deferred tax assets and liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

The provision for income tax expense and effective tax rates for the periods shown below were as follows:

(Dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Provision for income tax expense	\$ 2,990	\$ 3,207	\$ 8,666	\$ 7,984
Effective tax rate	18.61%	19.76%	18.62%	19.40%

The differences between the federal statutory rate of 21% and the effective tax rates presented in the table above were largely attributable to the non-taxable gain related to bank-owned life insurance.

Financial Condition

Total assets were \$3.4 billion as of September 30, 2019, compared to \$3.3 billion as of December 31, 2018, an increase of \$152.5 million primarily due to an increase in loans of \$230.0 million and a \$12.9 million increase due to operating lease right-to-use assets, partially offset by a \$92.7 million decrease in cash and cash equivalents.

Total liabilities increased primarily due to a \$120.0 million increase in FHLB advances and an increase of \$15.5 million due to operating lease liabilities, partially offset by a \$22.0 million decrease in deposits.

Operating lease right-to-use assets and operating lease liabilities were added due to the implementation of the new lease accounting standard. See Note 1 and Note 16 to the condensed consolidated financial statements for further discussion of the new lease accounting standard. See further analysis of the other changes in the related discussions that follow.

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Loan Portfolio

As of September 30, 2019, loans, excluding loans held for sale, were \$2.7 billion, an increase of \$230.0 million, or 9.4%, compared to \$2.4 billion at December 31, 2018. The increase in loans was primarily due to organic growth and increased capital needs of existing customers.

The loan portfolio by loan class as of the dates indicated was as follows:

(Dollars in thousands)	September 30, 2019	December 31, 2018	Increase (Decrease)	
Commercial and industrial	\$ 523,831	\$ 519,779	\$ 4,052	0.8%
Real estate:				
Commercial real estate	875,329	795,733	79,596	10.0%
Construction and development	572,276	515,533	56,743	11.0%
1-4 family residential	287,434	282,011	5,423	1.9%
Multi-family residential	298,396	221,194	77,202	34.9%
Consumer	37,975	39,421	(1,446)	(3.7%)
Agricultural	10,836	11,076	(240)	(2.2%)
Other	76,860	68,382	8,478	12.4%
Gross loans	2,682,937	2,453,129	229,808	9.4%
Less deferred fees and unearned discount	(6,113)	(6,306)	193	(3.1%)
Less loans held for sale	—	—	—	—
Loans, excluding loans held for sale	2,676,824	2,446,823	230,001	9.4%
Less allowance for loan losses	(25,576)	(23,693)	(1,883)	7.9%
Loans, net	<u>\$ 2,651,248</u>	<u>\$ 2,423,130</u>	<u>\$ 228,118</u>	<u>9.4%</u>
Loans as a percentage of deposits	96.61%	87.60%		
Loans as a percentage of total assets	77.26%	73.90%		

The contractual maturity ranges of loans in the loan portfolio and the amount of such loans with fixed and variable interest rates in each maturity range as of the dates indicated were as follows:

(Dollars in thousands)	1 Year or Less	1 Year Through 5 Years	After 5 Years	Total
<i>September 30, 2019</i>				
Commercial and industrial	\$ 249,869	\$ 251,152	\$ 22,810	\$ 523,831
Real estate:				
Commercial real estate	111,105	568,776	195,448	875,329
Construction and development	170,519	343,059	58,698	572,276
1-4 family residential	11,934	47,703	227,797	287,434
Multi-family residential	42,845	72,270	183,281	298,396
Consumer	24,664	13,204	107	37,975
Agricultural	9,361	1,475	—	10,836
Other	20,885	53,972	2,003	76,860
Total loans	<u>\$ 641,182</u>	<u>\$ 1,351,611</u>	<u>\$ 690,144</u>	<u>\$ 2,682,937</u>
Fixed rate loans	\$ 177,593	\$ 728,658	\$ 285,522	\$ 1,191,773
Variable rate loans	463,589	622,953	404,622	1,491,164

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Nonperforming assets include nonaccrual loans, loans that are accruing over 90 days past due and foreclosed assets. Generally loans are placed on nonaccrual status when they become more than 90 days past due and/or the collection of principal or interest is in doubt. The components of nonperforming assets as of the dates indicated were as follows:

<u>(Dollars in thousands)</u>	<u>September 30,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
Nonaccrual loans by category:		
Commercial and industrial	\$ 354	\$ 1,317
Real estate:		
Commercial real estate	159	1,517
1-4 family residential	629	656
Total nonaccrual loans	1,142	3,490
Accruing loans 90 or more days past due	—	—
Total nonperforming loans	1,142	3,490
Foreclosed assets:		
Real estate	—	12
Other	—	—
Total foreclosed assets	—	12
Total nonperforming assets	\$ 1,142	\$ 3,502
Nonperforming loans to total loans	0.04%	0.14%
Nonperforming assets to total assets	0.03%	0.11%

Risk Grading

As part of the on-going monitoring of the credit quality of the Company's loan portfolio and methodology for calculating the allowance for loan losses, management assigns and tracks loan grades as described below that are used as credit quality indicators.

Pass—Credits in this category contain an acceptable amount of risk.

Special Mention—Credits in this category contain more than the normal amount of risk and are referred to as "*special mention*" in accordance with regulatory guidelines. These credits possess clearly identifiable temporary weaknesses or trends that, if not corrected or revised, may result in a condition that exposes the Company to higher level of risk of loss.

Substandard—Credits in this category are "*substandard*" in accordance with regulatory guidelines and of unsatisfactory credit quality with well-defined weaknesses or weaknesses that jeopardize the liquidation of the debt. Credits in this category are inadequately protected by the current sound worth and paying capacity of the obligor or the collateral pledged, if any. Often, the assets in this category will have a valuation allowance representative of management's estimated loss that is probable to be incurred. Loans deemed substandard and on nonaccrual status are considered impaired and are individually evaluated for impairment.

Doubtful—Credits in this category are considered "*doubtful*" in accordance with regulatory guidelines, are placed on nonaccrual status and may be dependent upon collateral having a value that is difficult to determine or upon some near-term event which lacks certainty. Generally, these credits will have a valuation allowance based upon management's best estimate of the losses probable to occur in the liquidation of the debt.

Loss—Credits in this category are considered "*loss*" in accordance with regulatory guidelines and are considered uncollectible and of such little value as to question their continued existence as assets on the Company's financial statements. Such credits are to be charged off or charged down when payment is acknowledged to be uncertain or when the timing or value of payments cannot be determined. This category does not intend to imply that the debt or some portion of it will never be paid, nor does it in any way imply that the debt will be forgiven.

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The Company had no loans graded “loss” or “doubtful” at September 30, 2019 and December 31, 2018.

The internal ratings of loans as of the dates indicated were as follows:

(Dollars in thousands)	Pass	Special Mention	Substandard	Total
September 30, 2019				
Commercial and industrial	\$ 507,785	\$ 4,160	\$ 11,886	\$ 523,831
Real estate:				
Commercial real estate	852,731	20,879	1,719	875,329
Construction and development	558,148	14,128	—	572,276
1-4 family residential	281,463	599	5,372	287,434
Multi-family residential	298,396	—	—	298,396
Consumer	37,724	—	251	37,975
Agricultural	10,756	50	30	10,836
Other	70,164	—	6,696	76,860
Total	\$ 2,617,167	\$ 39,816	\$ 25,954	\$ 2,682,937

(Dollars in thousands)	Pass	Special Mention	Substandard	Total
December 31, 2018				
Commercial and industrial	\$ 504,425	\$ 5,768	\$ 9,586	\$ 519,779
Real estate:				
Commercial real estate	781,035	10,370	4,328	795,733
Construction and development	511,329	4,204	—	515,533
1-4 family residential	274,781	2,175	5,055	282,011
Multi-family residential	221,194	—	—	221,194
Consumer	39,140	246	35	39,421
Agricultural	11,048	—	28	11,076
Other	61,569	—	6,813	68,382
Total	\$ 2,404,521	\$ 22,763	\$ 25,845	\$ 2,453,129

Allowance for Loan Losses

The Company maintains an allowance for loan losses that represents management’s best estimate of the loan losses and risks inherent in the loan portfolio. The amount of the allowance for loan losses should not be interpreted as an indication that charge-offs in future periods will necessarily occur in those amounts. In determining the allowance for loan losses, the Company estimates losses on specific loans, or groups of loans, where the probable loss can be identified and reasonably determined. The balance of the allowance for loan losses is based on internally assigned risk classifications of loans, historical loan loss rates, changes in the loan portfolio, overall portfolio quality, industry concentrations, delinquency trends, current economic factors and the estimated impact of current economic conditions on certain historical loan loss rates. See “—Critical Accounting Policies—Loans and Allowance for Loan Losses.”

In reviewing the loan portfolio, the Company considers risk elements applicable to particular loan types or categories to assess the quality of individual loans. Some of the risk elements considered include:

Commercial and industrial loans—the debt service coverage ratio (income from the business in excess of operating expenses compared to loan repayment requirements), the operating results of the commercial, industrial or professional enterprise, the borrower’s business, professional and financial ability and expertise, the specific risks and volatility of income and operating results typical for businesses in that category and the value, nature and marketability of collateral;

Commercial real estate loans and multi-family residential loans—the debt service coverage ratio, operating results of the owner in the case of owner-occupied properties, the loan-to-value ratio, the age and condition of the collateral and the volatility of income, property value and future operating results typical of properties of that type;

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1-4 family residential mortgage loans—the borrower’s ability to repay the loan, including a consideration of the debt-to-income ratio and employment and income stability, the loan-to-value ratio and the age, condition and marketability of the collateral; and

Construction and development loans—the perceived feasibility of the project including the ability to sell developed lots or improvements constructed for resale or the ability to lease property constructed for lease, the quality and nature of contracts for presale or prelease, if any, experience and ability of the developer and loan-to-value ratio.

Activity in the allowance for loan losses as of the dates indicated was as follows:

(Dollars in thousands)	Nine Months Ended September 30,	
	2019	2018
Allowance for loan losses at beginning of period	\$ 23,693	\$ 24,778
Provision for loan losses	2,533	413
Charge-offs:		
Commercial and industrial	869	1,136
Real estate:		
Commercial real estate	44	9
1-4 family residential	12	3
Consumer	88	1
Other	52	3
Total charge-offs	1,065	1,152
Recoveries:		
Commercial and industrial	311	424
Real estate:		
Commercial real estate	81	14
1-4 family residential	3	5
Consumer	15	2
Other	5	2
Total recoveries	415	447
Net charge-offs	(650)	(705)
Allowance for loan losses at end of period	\$ 25,576	\$ 24,486
Allowance for loan losses to end of period loans	0.96%	0.99%
Net charge-offs to average loans ⁽¹⁾	0.03%	0.04%

(1) Annualized.

The allowance for loan losses by loan category as of the periods indicated was as follows:

(Dollars in thousands)	September 30, 2019		December 31, 2018	
	Amount	Percent	Amount	Percent
Commercial and industrial	\$ 7,470	29.2 %	\$ 7,719	32.6 %
Real estate:				
Commercial real estate	7,788	30.5 %	6,730	28.4 %
Construction and development	4,825	18.9 %	4,298	18.1 %
1-4 family residential	2,338	9.1 %	2,281	9.6 %
Multi-family residential	1,829	7.1 %	1,511	6.4 %
Consumer	558	2.2 %	387	1.6 %
Agricultural	82	0.3 %	62	0.3 %
Other	686	2.7 %	705	3.0 %
Total allowance for loan losses	\$ 25,576	100.0 %	\$ 23,693	100.0 %

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Securities

As of September 30, 2019, the carrying amount of the Company's securities totaled \$228.1 million compared to \$230.0 million as of December 31, 2018, a decrease of \$1.9 million or 0.8%. Amortized cost decreased \$8.8 million as a result of maturities, sales, calls and paydowns outpacing purchases. The unrealized gains (losses) of the security portfolio was a net gain of \$3.1 million at September 30, 2019 and a net loss of \$3.8 million at December 31, 2018. This change of \$6.9 million was due to changing market interest rates.

Amortized cost and estimated fair value of investments in securities as of the dates shown was as follows.

<u>(Dollars in thousands)</u>	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
September 30, 2019				
Debt securities available for sale:				
State and municipal securities	\$ 51,240	\$ 1,862	\$ (8)	\$ 53,094
U.S. agency securities:				
Collateralized mortgage obligations	60,974	471	(106)	61,339
Mortgage-backed securities	111,550	1,203	(300)	112,453
Equity securities	1,149	—	(3)	1,146
Total	\$ 224,913	\$ 3,536	\$ (417)	\$ 228,032
Debt securities held to maturity:				
Mortgage-backed securities	\$ 29	\$ 2	\$ —	\$ 31

<u>(Dollars in thousands)</u>	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
December 31, 2018				
Debt securities available for sale:				
State and municipal securities	\$ 57,972	\$ 345	\$ (626)	\$ 57,691
U.S. agency securities:				
Debt securities	17,315	—	(434)	16,881
Collateralized mortgage obligations	66,438	98	(1,122)	65,414
Mortgage-backed securities	90,845	230	(2,216)	88,859
Equity securities	1,129	—	(41)	1,088
Total	\$ 233,699	\$ 673	\$ (4,439)	\$ 229,933
Debt securities held to maturity:				
Mortgage-backed securities	\$ 31	\$ 1	\$ —	\$ 32

The Company held 33 securities at September 30, 2019 and 100 securities at December 31, 2018, respectively, that were in a gross unrealized loss position for 12 months or more as illustrated in the table below. The unrealized losses are attributable primarily to changes in market interest rates relative to those available when the securities were acquired. The fair value of these securities is expected to recover as the securities reach their maturity or re-pricing date, or if changes in market rates for such investments decline. Management does not believe that any of the securities the Company holds are impaired due to reasons of credit quality and believes the unrealized losses detailed in the tables below are temporary. No impairment loss has been recorded in the Company's condensed consolidated statements of income for the nine months ended September 30, 2019 and 2018.

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Securities with unrealized losses as of the dates shown below, aggregated by category and the length of time were as follows:

(Dollars in thousands)	Less Than Twelve Months		Twelve Months or More	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
September 30, 2019				
Debt securities available for sale:				
State and municipal securities	\$ 2,043	\$ (7)	\$ 106	\$ (1)
U.S. agency securities:				
Collateralized mortgage obligations	10,514	(39)	8,580	(67)
Mortgage-backed securities	16,946	(40)	27,186	(260)
Equity securities	—	—	1,146	(3)
	<u>\$ 29,503</u>	<u>\$ (86)</u>	<u>\$ 37,018</u>	<u>\$ (331)</u>
December 31, 2018				
Debt securities available for sale:				
State and municipal securities	\$ 20,892	\$ (324)	\$ 6,584	\$ (302)
U.S. agency securities:				
Debt securities	—	—	16,882	(434)
Collateralized mortgage obligations	8,854	(81)	46,157	(1,041)
Mortgage-backed securities	21,745	(368)	46,183	(1,848)
Equity securities	—	—	1,088	(41)
	<u>\$ 51,491</u>	<u>\$ (773)</u>	<u>\$ 116,894</u>	<u>\$ (3,666)</u>

The Company's mortgage-backed securities at September 30, 2019 and December 31, 2018, were agency securities. The Company does not hold any Fannie Mae or Freddie Mac preferred stock, corporate equity, collateralized debt obligations, collateralized loan obligations, structured investment vehicles, private label collateralized mortgage obligations, subprime, Alt-A or second lien elements in the securities portfolio.

Contractual maturities and weighted-average yield based on annualized income divided by the average amortized cost of the available for sale securities portfolio as of the date indicated was as follows:

(Dollars in thousands)	1 Year or Less		After 1 Year to 5 years		After 5 Years to 10 Years		After 10 Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Total	Yield
September 30, 2019										
Debt securities:										
State and municipal securities	\$ 1,366	2.7 %	\$ 1,409	2.5 %	\$ 7,948	2.6 %	\$ 42,371	2.9 %	\$ 53,094	2.9 %
U.S. agency securities:										
Collateralized mortgage obligations	—	— %	—	— %	4,952	2.5 %	56,387	2.5 %	61,339	2.5 %
Mortgage-backed securities	30	2.4 %	1,945	3.8 %	1,305	3.3 %	109,173	2.6 %	112,453	2.6 %
Equity securities	1,146	2.3 %	—	— %	—	— %	—	— %	1,146	2.3 %
Total securities	<u>\$ 2,542</u>	<u>2.5 %</u>	<u>\$ 3,354</u>	<u>3.2 %</u>	<u>\$ 14,205</u>	<u>2.7 %</u>	<u>\$ 207,931</u>	<u>2.6 %</u>	<u>\$ 228,032</u>	<u>2.6 %</u>

The contractual maturity of a collateralized mortgage obligation or mortgage-backed security is the date at which the last underlying mortgage matures and is not a reliable indicator of their expected life because borrowers have the right to prepay their obligations at any time. The weighted-average life of the securities portfolio was 4.0 years with an estimated modified duration of 3.7 years as of September 30, 2019.

A portion of the securities have contractual maturities extending beyond 10 years, bear fixed rates of interest and are collateralized by residential mortgages. Repayment of principal on these bonds is primarily dependent on the cash flows received from payments on the underlying collateral to the bond issuer and therefore, the likelihood of prepayment

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is impacted by the economic environment. During a period of increasing interest rates, fixed rate mortgage-backed securities do not tend to experience heavy prepayments and as a result, the average lives of these securities are lengthened. If interest rates fall, prepayments tend to increase and as a result the lives of these securities are shortened.

As of September 30, 2019, the Company did not own securities of any one issuer, other than the U.S. government and its agencies, for which aggregate adjusted cost exceeded 10.0% of consolidated shareholders' equity.

Deposits

Total deposits as of September 30, 2019, were \$2.7 billion, a decrease of \$22.0 million, or 0.8%, compared to December 31, 2018. Noninterest-bearing deposits as of September 30, 2019, were \$1.2 billion, an increase of \$13.7 million, or 1.2%, compared to December 31, 2018. Total interest-bearing account balances as of September 30, 2019, were \$1.5 billion, a decrease of \$35.6 million, or 2.2% from December 31, 2018. The changes in deposits from December 31, 2018 to September 30, 2019 are due to normal fluctuations in customer activities.

The components of deposits at the dates shown below were as follows:

(Dollars in thousands)	September 30, 2019		December 31, 2018	
	Amount	Percent	Amount	Percent
Interest-bearing demand accounts	\$ 337,746	12.3%	\$ 387,457	14.0%
Money market accounts	739,436	26.9%	737,770	26.7%
Saving accounts	91,413	3.3%	96,962	3.5%
Certificates and other time deposits, \$100,000 or greater	198,561	7.3%	189,007	6.8%
Certificates and other time deposits, less than \$100,000	180,451	6.6%	172,028	6.2%
Total interest-bearing deposits	1,547,607	56.4%	1,583,224	57.2%
Noninterest-bearing deposits	1,196,720	43.6%	1,183,058	42.8%
Total deposits	\$ 2,744,327	100.0%	\$ 2,766,282	100.0%

At September 30, 2019 and December 31, 2018, the Company had \$57.3 million and \$51.5 million in deposits from public entities and brokered deposits of \$117.2 million and \$104.5 million, respectively. The Company had no major concentrations of deposits at September 30, 2019 or December 31, 2018 from any single or related groups of depositors.

Certificates of deposit by time remaining until maturity as of the dates indicated were as follows:

(Dollars in thousands)	September 30, 2019	December 31, 2018
Three months or less	\$ 70,945	\$ 71,817
Over three months through six months	67,718	50,966
Over six months through 12 months	134,659	119,180
Over 12 months through three years	89,055	108,436
Over three years	16,635	10,636
Total	\$ 379,012	\$ 361,035

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Average balances and average rates paid on deposits for the periods indicated are shown in the table below. Average rates paid for the nine months ended September 30, 2019 were computed on an annualized basis.

(Dollars in thousands)	Nine Months Ended September 30, 2019		Year Ended December 31, 2018	
	Average Balance	Average Rate	Average Balance	Average Rate
Interest-bearing demand accounts	\$ 353,265	0.25 %	\$ 362,498	0.23 %
Savings accounts	93,786	0.06 %	94,754	0.06 %
Money market accounts	722,451	1.26 %	714,565	0.87 %
Certificates and other time deposits, \$100,000 or greater	188,087	1.32 %	173,160	0.79 %
Certificates and other time deposits, less than \$100,000	181,204	1.58 %	174,666	1.23 %
Total interest-bearing deposits	1,538,793	1.00 %	1,519,643	0.70 %
Noninterest-bearing deposits	1,186,985	—	1,134,191	—
Total deposits	\$ 2,725,778	0.57 %	\$ 2,653,834	0.40 %

The ratio of average noninterest-bearing deposits to average total deposits was 43.5% for the nine months ended September 30, 2019 and 42.7% for the year ended December 31, 2018.

Borrowings

Frost Line of Credit. The Company has entered into a loan agreement, or the Loan Agreement, with Frost Bank, which provides for a \$30.0 million revolving line of credit, or Line of Credit. The Loan Agreement was amended and restated on December 13, 2018 and, as amended, is referred to as the Amended Agreement. The Company can make draws on the Line of Credit for a period of 12 months beginning on the date of the Amended Agreement, after which the Company will not be permitted to make further draws and the outstanding balance will amortize over a period of 60 months. Interest accrues on outstanding borrowings at a rate equal to the maximum “Latest” U.S. prime rate of interest per annum and payable quarterly in the first 12 months and thereafter quarterly principal and interest payments are required over a term of 60 months. The entire outstanding balance and unpaid interest is payable in full on December 13, 2024.

The Company may prepay the principal amount of any loan under the Amended Agreement without premium or penalty. The obligations of the Company under the Amended Agreement are secured by a valid and perfected first priority lien on all of the issued and outstanding shares of capital stock of the Bank.

Covenants made under the Amended Agreement include, among other things, the Company maintaining tangible net worth of not less than \$300 million, the Company maintaining free cash flow coverage ratio of not less than 1.25 to 1.00, the Bank’s Texas Ratio (as defined under the Amended Agreement) not to exceed 15%, the Bank’s Total Capital Ratio (as defined under the Amended Agreement) of not less than 12% and restrictions on the ability of the Company and its subsidiaries to incur certain additional debt. The Company was in compliance with these covenants at September 30, 2019.

As of September 30, 2019, there were no outstanding borrowings on the Line of Credit and the Company has not drawn on this line since the Company entered the agreement.

FHLB Advances

The FHLB allows the Company to borrow on a blanket floating lien status collateralized by certain loans. As of September 30, 2019 and December 31, 2018, total borrowing capacity of \$950.8 million and \$919.9 million, respectively, was available under this arrangement. During the nine months ended September 30, 2019 and 2018, the Company borrowed under this agreement on a short-term basis. As of September 30, 2019, \$120.0 million of FHLB advances were outstanding and they matured in less than thirty days. At December 31, 2018, there were no outstanding FHLB advances. The average outstanding balance for FHLB advances for the nine months ended September 30, 2019 and 2018 was \$59.1 million and \$4.5 million, respectively. The increase in FHLB advances during the three and nine months ended September

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30, 2019 was due to loan growth during the respective periods. The weighted-average rate for the nine months ended September 30, 2019 and 2018 was 2.42% and 2.18%, respectively.

Liquidity and Capital Resources

Liquidity

Liquidity involves our ability to raise funds to support asset growth and acquisitions or reduce assets to meet deposit withdrawals and other payment obligations, to maintain reserve requirements and otherwise to operate on an ongoing basis and manage unexpected events. The Company's primary source of funds is deposits and the primary use of funds is loans. Historically, the cost of the Company's deposits has been lower than other sources of funds available, such as debt. The Company does not expect a change in the primary source or use of funds in the foreseeable future. The composition of funding sources and uses as a percentage of average total assets for the periods indicated was as follows:

	Nine Months Ended September 30, 2019	Year Ended December 31, 2018
Sources of funds:		
Deposits:		
Interest-bearing	46.2 %	48.1 %
Noninterest-bearing	35.6 %	35.9 %
FHLB advances and repurchase agreements	1.8 %	0.2 %
Note payable and junior subordinated debt	— %	0.4 %
Other liabilities	1.1 %	0.7 %
Shareholders' equity	15.3 %	14.7 %
Total sources	<u>100.0 %</u>	<u>100.0 %</u>
Uses of funds:		
Loans	77.6 %	75.8 %
Securities	7.0 %	7.2 %
Other interest-earning assets	6.7 %	8.1 %
Equity securities	0.4 %	0.5 %
Other noninterest-earning assets	8.3 %	8.4 %
Total uses	<u>100.0 %</u>	<u>100.0 %</u>
Average loans to average deposits	94.8 %	90.1 %

As of September 30, 2019, the Company had \$783.9 million in outstanding commitments to extend credit and \$26.7 million in commitments associated with outstanding standby and commercial letters of credit. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the total outstanding may not necessarily reflect the actual future cash funding requirements.

As of September 30, 2019, there was no exposure to future cash requirements associated with known uncertainties or capital expenditure of a material nature.

As of September 30, 2019, cash and cash equivalents was \$289.4 million, compared to \$382.1 million as of December 31, 2018, a decrease of \$92.7 million. The decrease was primarily due to an increase in loans of \$230.0 million, a \$22.0 million decrease in deposits, partially offset by a \$120.0 million increase in FHLB advances and net income of \$37.9 million. See the condensed consolidated statement of cash flows for the nine months ended September 30, 2019 for additional analysis.

Capital Resources

Total shareholders' equity increased to \$525.2 million as of September 30, 2019, compared to \$487.6 million as of December 31, 2018, an increase of \$37.6 million, or 4.7%, primarily due the current year income of \$37.9 million, a \$5.4 million increase in other comprehensive income and \$1.7 million of stock compensation expense, partially offset by \$7.5 million in dividends to common shareholders declared during the nine months ended September 30, 2019.

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In July 2019, the Company's Board of Directors authorized a share repurchase program under which the Company may repurchase up to \$40.0 million of the Company's common stock through September 30, 2020. During the nine months ended September 30, 2019, 100 shares were repurchased at \$27.98 per share and retired.

As a general matter, FDIC insured depository institutions and their holding companies are required to maintain minimum capital relative to the amount and types of assets they hold. The Company and the Bank are both subject to regulatory capital requirements. At September 30, 2019 and December 31, 2018, the Company and the Bank were in compliance with all applicable regulatory capital requirements at the bank holding company and bank levels, and the Bank was classified as "well capitalized" for purposes of the FDIC's prompt corrective action regulations. The OCC or the FDIC may require the Bank to maintain capital ratios above the required minimums and the Federal Reserve may require the Company to maintain capital ratios above the required minimums. The following table presents the regulatory capital ratios for our Company and the Bank as of the dates indicated.

(Dollars in thousands)	Actual		Minimum Capital Required for Capital Adequacy Purposes		Minimum Capital Required Basel III Fully Phased-in		Required to be Considered Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2019								
Common Equity Tier I to Risk-Weighted Assets:								
Consolidated	\$ 437,738	14.99%	\$ 131,426	4.50%	\$ 204,440	7.00%	N/A	N/A
Bank Only	\$ 396,161	13.57%	\$ 131,415	4.50%	\$ 204,424	7.00%	\$ 189,822	6.50%
Tier I Capital to Risk-Weighted Assets:								
Consolidated	\$ 437,738	14.99%	\$ 175,234	6.00%	\$ 248,248	8.50%	N/A	N/A
Bank Only	\$ 396,161	13.57%	\$ 175,220	6.00%	\$ 248,229	8.50%	\$ 233,627	8.00%
Total Capital to Risk-Weighted Assets:								
Consolidated	\$ 463,692	15.88%	\$ 233,646	8.00%	\$ 306,660	10.50%	N/A	N/A
Bank Only	\$ 422,115	14.45%	\$ 233,627	8.00%	\$ 306,635	10.50%	\$ 292,034	10.00%
Tier I Leverage Capital to Average Assets:								
Consolidated	\$ 437,738	13.23%	\$ 132,358	4.00%	\$ 132,358	4.00%	N/A	N/A
Bank Only	\$ 396,161	11.97%	\$ 132,344	4.00%	\$ 132,344	4.00%	\$ 165,430	5.00%
December 31, 2018								
Common Equity Tier I to Risk-Weighted Assets:								
Consolidated	\$ 405,012	14.71%	\$ 123,885	4.50%	\$ 192,710	7.00%	N/A	N/A
Bank Only	\$ 363,140	13.19%	\$ 123,877	4.50%	\$ 192,697	7.00%	\$ 178,933	6.50%
Tier I Capital to Risk-Weighted Assets:								
Consolidated	\$ 406,257	14.76%	\$ 165,180	6.00%	\$ 234,005	8.50%	N/A	N/A
Bank Only	\$ 363,140	13.19%	\$ 165,169	6.00%	\$ 233,989	8.50%	\$ 220,225	8.00%
Total Capital to Risk-Weighted Assets:								
Consolidated	\$ 430,238	15.63%	\$ 220,240	8.00%	\$ 289,065	10.50%	N/A	N/A
Bank Only	\$ 387,211	14.07%	\$ 220,225	8.00%	\$ 289,046	10.50%	\$ 275,282	10.00%
Tier I Leverage Capital to Average Assets:								
Consolidated	\$ 406,257	12.74%	\$ 127,350	4.00%	\$ 127,350	4.00%	N/A	N/A
Bank Only	\$ 363,140	11.41%	\$ 127,350	4.00%	\$ 127,350	4.00%	\$ 159,188	5.00%

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Contractual Obligations

In the normal course of operations, the Company enters into certain contractual obligations, such as obligations for operating leases, certificates of deposits and borrowings. Future cash payments associated with contractual obligations, as of the dates indicated were as follows:

(Dollars in thousands)	Less than 1 year	1 year to 3 years	3 year to 5 years	Greater than 5 years	Total
September 30, 2019					
Federal Home Loan Bank advances	\$ 120,000	\$ —	\$ —	\$ —	\$ 120,000
Non-cancelable future operating leases	1,991	4,302	4,008	9,602	19,903
Certificates of deposit	273,322	89,055	16,635	—	379,012
Total	<u>\$ 395,313</u>	<u>\$ 93,357</u>	<u>\$ 20,643</u>	<u>\$ 9,602</u>	<u>\$ 518,915</u>
December 31, 2018					
Non-cancelable future operating leases	\$ 2,118	\$ 4,363	\$ 4,565	\$ 10,048	\$ 21,094
Certificates of deposit	241,963	108,436	10,636	—	361,035
Junior subordinated debt	1,571	—	—	—	1,571
Total	<u>\$ 245,652</u>	<u>\$ 112,799</u>	<u>\$ 15,201</u>	<u>\$ 10,048</u>	<u>\$ 383,700</u>

In January 2019, the trust preferred securities underlying the junior subordinated debt outstanding at December 31, 2018 were redeemed.

Off-Balance Sheet Arrangements

In the normal course of business, the Company enters into various transactions, which, in accordance with GAAP, are not included in the consolidated balance sheets. These transactions are entered into to meet the customer financing needs. These transactions include commitments to extend credit and standby and commercial letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in our consolidated balance sheets.

Commitments associated with outstanding standby and commercial letters of credit and commitments to extend credit expiring by period as of the date indicated are summarized below.

(Dollars in thousands)	1 year or less	More than 1 year but less than 3 years	3 years or more but less than 5 years	5 years or more	Total
September 30, 2019					
Standby letters of credit	\$ 18,120	\$ 3,592	\$ 5,000	\$ —	\$ 26,712
Commitments to extend credit	457,114	282,137	37,377	7,263	783,891
Total	<u>\$ 475,234</u>	<u>\$ 285,729</u>	<u>\$ 42,377</u>	<u>\$ 7,263</u>	<u>\$ 810,603</u>
December 31, 2018					
Standby letters of credit	\$ 22,789	\$ 3,940	\$ 5,000	\$ —	\$ 31,729
Commitments to extend credit	486,480	267,099	14,415	63,642	831,636
Total	<u>\$ 509,269</u>	<u>\$ 271,039</u>	<u>\$ 19,415</u>	<u>\$ 63,642</u>	<u>\$ 863,365</u>

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. In the event of nonperformance by the customer, the Company has rights to the underlying collateral, which can include commercial real estate, physical plant and property, inventory, receivables, cash and/or marketable securities. The Company's credit risk associated with issuing letters of credit is essentially the same as the risk involved in extending loan facilities to our customers.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and

may require payment of a fee. Since many of the commitments are expected to expire without being fully drawn upon, the total commitment amounts disclosed above do not necessarily represent future cash requirements.

Interest Rate Sensitivity and Market Risk

As a financial institution, the Company's primary component of market risk is interest rate volatility. The Company's asset, liability and funds management policy provides management with the guidelines for effective funds management. A measurement system for monitoring net interest rate sensitivity position has been established and the Company has historically managed its sensitivity position within its established guidelines.

Fluctuations in interest rates will ultimately impact both the level of income and expense recorded on most of the Company's assets and liabilities and the market value of all interest-earning assets and interest-bearing liabilities, other than those which have a short-term to maturity. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a decrease in current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximizing income.

The Company manages exposure to interest rates by structuring our balance sheet in the ordinary course of business. The Company does not enter into instruments such as leveraged derivatives, financial options, financial future contracts or forward delivery contracts to reduce interest rate risk. Based upon the nature of our operations, the Company is not subject to foreign exchange or commodity price risk and does not own any trading assets.

The Company's exposure to interest rate risk is managed by the Funds Management Committee of the Bank, in accordance with policies approved by the Bank's Board of Directors. The committee formulates strategies based on appropriate levels of interest rate risk. In determining the appropriate level of interest rate risk, the committee considers the impact on earnings and capital of the current outlook on interest rates, potential changes in interest rates, regional economies, liquidity, business strategies and other factors. The committee meets regularly to review, among other things, the sensitivity of assets and liabilities to interest rate changes, the book and market values of assets and liabilities, unrealized gains and losses, purchase and sale activities, commitments to originate loans and the maturities of investments and borrowings. Additionally, the committee reviews liquidity, cash flow flexibility, maturities of deposits and consumer and commercial deposit activity. Management employs methodologies to manage interest rate risk, which include an analysis of relationships between interest-earning assets and interest-bearing liabilities and an interest rate shock simulation model.

The Company uses interest rate risk simulation models and shock analyses to test the interest rate sensitivity of net interest income and fair value of equity and the impact of changes in interest rates on other financial metrics. Contractual maturities and re-pricing opportunities of loans are incorporated in the model, as are prepayment assumptions, maturity data and call options within the investment portfolio. Average life of non-maturity deposit accounts are based on standard regulatory decay assumptions and are incorporated into the model. The assumptions used are inherently uncertain and the model cannot precisely measure future net interest income or precisely predict the impact of fluctuations in market interest rates on net interest income. Actual results will differ from the model's simulated results due to timing, magnitude and frequency of interest rate changes as well as changes in market conditions and the application and timing of various management strategies.

On a quarterly basis, two simulation models are run, including a static balance sheet and dynamic growth balance sheet. These models test the impact on net interest income and fair value of equity from changes in market interest rates under various scenarios. Under the static and dynamic growth models, rates are shocked instantaneously and ramped rate changes over a 12-month horizon based upon parallel and non-parallel yield curve shifts. Parallel shock scenarios assume instantaneous parallel movements in the yield curve compared to a flat yield curve scenario. Non-parallel simulation involves analysis of interest income and expense under various changes in the shape of the yield curve. The Company's internal policy regarding internal rate risk simulations currently specifies that for instantaneous parallel shifts of the yield curve, estimated net income at risk for the subsequent one-year period should not decline by more than 10% for a 100 basis-point shift, 20% for a 200-basis point shift and 30% for a 300-basis point shift.

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Simulated change in net interest income and fair value of equity over a 12-month horizon as of the dates indicated below were as follows:

Change in Interest Rates (Basis Points)	September 30, 2019		December 31, 2018	
	Percent Change in Net Interest Income	Percent Change in Fair Value of Equity	Percent Change in Net Interest Income	Percent Change in Fair Value of Equity
+ 300	14.9 %	11.0 %	16.7 %	(3.1)%
+ 200	10.4 %	12.0 %	11.6 %	(0.4)%
+ 100	5.5 %	9.0 %	6.1 %	1.1 %
Base	— %	— %	— %	— %
-100	(4.9)%	(16.0)%	(6.8)%	(7.6)%

The results are primarily due to behavior of demand, money market and savings deposits during such rate fluctuations. Historically, interest rates on these deposits have changed more slowly than changes in the discount and federal funds rates. This assumption is incorporated into the simulation model and is generally not fully reflected in a gap analysis. The assumptions incorporated into the model are inherently uncertain and, as a result, the model cannot precisely measure future net interest income or precisely predict the impact of fluctuations in market interest rates on net interest income. Actual results will differ from the model's simulated results due to timing, magnitude and frequency of interest rate changes as well as changes in market conditions and the application and timing of various strategies.

LIBOR Transition

The London Interbank Offered Rate, or LIBOR, is used as an index rate for the Company's interest-rate swaps and approximately 9% of the Company's loans. It is expected that a number of private-sector banks that have been reporting information used to set LIBOR will stop doing so after 2021 when their reporting commitment ends. As a result, LIBOR may no longer be available as an index or may be seen as no longer representative of the market. Alternative reference rates are being identified, but existing contracts may not have been written to allow the use of these alternatives. The Company is evaluating the risks related to this transition and its evaluation and mitigation of risks related to the discontinuation of LIBOR may span several reporting periods through 2021.

Impact of Inflation

The Company's condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q have been prepared in accordance with GAAP. GAAP requires the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative value of money over time due to inflation or recession.

Unlike many industrial companies, substantially all of the Company's assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on our performance than the effects of general levels of inflation. Interest rates may not necessarily move in the same direction or in the same magnitude as the prices of goods and services. However, other operating expenses do reflect general levels of inflation.

Non-GAAP Financial Measures

The Company's accounting and reporting policies conform to GAAP and the prevailing practices in the banking industry. However, the Company also evaluates its performance based on certain additional non-GAAP financial measures. A financial measure is considered to be a non-GAAP financial measure if that financial measure excludes or includes amounts, or is subject to adjustments that have the effect of excluding or including amounts, that are not included or excluded in the most directly comparable measure calculated and presented in accordance with GAAP as in effect from time to time in the U.S. in the Company's statements of income, balance sheets or statements of cash flows. Non-GAAP financial measures do not include operating and other statistical measures or ratios or statistical measures calculated using exclusively financial measures calculated in accordance with GAAP. Non-GAAP financial measures should not be considered in isolation or as a substitute for the most directly comparable or other financial measures calculated in accordance with GAAP. Moreover, the way the Company calculates the non-GAAP financial measures may differ from that of other companies reporting measures with similar names.

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The Company calculates tangible equity as total shareholders' equity, less goodwill and other intangible assets, net of accumulated amortization and tangible book value per share as tangible equity divided by shares of common stock outstanding at the end of the relevant period. The most directly comparable GAAP financial measure for tangible book value per share is book value per share. The Company calculates tangible assets as total assets less goodwill and other intangible assets, net of accumulated amortization. The most directly comparable GAAP financial measure for tangible equity to tangible assets is total shareholders' equity to total assets. The Company believes that tangible book value per share and tangible equity to tangible assets are measures that are important to many investors in the marketplace who are interested in book value per share and total shareholders' equity to total assets, exclusive of change in intangible assets.

(Dollars in thousands, except per share data)	September 30, 2019	December 31, 2018
Tangible Equity		
Total shareholders' equity	\$ 525,220	\$ 487,625
Adjustments:		
Goodwill	80,950	80,950
Other intangibles	5,106	5,775
Tangible equity	<u>\$ 439,164</u>	<u>\$ 400,900</u>
Tangible Assets		
Total assets	\$ 3,431,585	\$ 3,279,096
Adjustments:		
Goodwill	80,950	80,950
Other intangibles	5,106	5,775
Tangible assets	<u>\$ 3,345,529</u>	<u>\$ 3,192,371</u>
Common shares outstanding	24,923	24,907
Book value per share	\$ 21.07	\$ 19.58
Tangible book value per share	\$ 17.62	\$ 16.10
Total shareholders' equity to total assets	15.31%	14.87%
Tangible equity to tangible assets	13.13%	12.56%

Critical Accounting Policies

The Company's accounting policies are described in Note 1 to the consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2018. The Company believes that the following accounting policies involve a higher degree of judgment and complexity:

Allowance for Loan Losses

The allowance for loan losses represents management's estimate of probable and reasonably estimable credit losses inherent in the loan portfolio. In determining the allowance, the Company estimates losses on individual impaired loans, or groups of loans which are not impaired, where the probable loss can be identified and reasonably estimated. On a quarterly basis, the risk inherent in the loan portfolio based on qualitative and quantitative trends in the portfolio is assessed, including the internal risk classification of loans, historical loss rates, changes in the nature and volume of the loan portfolio, industry or borrower concentrations, delinquency trends, detailed reviews of significant loans with identified weaknesses and the impacts of local, regional and national economic factors on the quality of the loan portfolio.

Determining the amount of the allowance is considered a critical accounting estimate, as it requires significant judgment and the use of subjective measurements, including management's assessment of overall portfolio quality. The Company maintains the allowance at an amount it believes is sufficient to provide for estimated losses inherent in the loan portfolio at each balance sheet date. Fluctuations in the provision for loan losses may result from management's assessment of the adequacy of the allowance. Changes in these estimates and assumptions are possible and may have a material impact on the allowance, and therefore the Company's financial position, liquidity or results of operations. For a description of

the factors considered in determining the allowance for loan losses see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Financial Condition—Allowance for Loan Losses.”

Fair Values of Financial Instruments

The fair values of the Company’s financial instruments are based upon quoted market prices, where available. If quoted market prices are not available, fair value is estimated based upon models that primarily use observable market-based parameters as inputs. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Goodwill and Other Intangibles

Goodwill, which is excess purchase price over the fair value of net assets from acquisitions, is evaluated for impairment at least annually and on an interim basis if events or circumstances indicate that it is likely an impairment has occurred. Qualitative factors are assessed to determine if it is likely that the fair value of a reporting unit is less than its carrying amount. If it is determined that it is likely that the fair value of a reporting unit is less than its carrying amount, the fair value of the reporting unit is compared with the carrying amount of the reporting unit. The fair value of net assets is estimated based on an analysis of market value. Impairment exists if the fair value of the reporting unit at the date of the test is less than the goodwill recorded. If goodwill is impaired, a loss would then be recognized in the consolidated financial statements to the extent of the impairment.

Determining the fair value of goodwill is considered a critical accounting estimate because the allocation of the fair value of goodwill to assets and liabilities requires significant management judgment and the use of subjective measurements. Variability in the market and changes in assumptions or subjective measurements used to allocate fair value are reasonably possible and may have a material impact on the Company’s financial position, liquidity or results of operations.

The Company’s other intangible assets include core deposits, loan servicing assets and customer relationship intangibles, which can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset, or liability. Other intangible assets are tested for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Emerging Growth Company

The Jump Start Our Business Start-ups, or JOBS Act permits an “emerging growth company” to take advantage of an extended transition period to comply with new or revised accounting standards applicable to public companies. The Company decided not to take advantage of this provision and is complying with new or revised accounting standards to the same extent that compliance is required for non-emerging growth companies. The decision to opt out of the extended transition period under the JOBS Act is irrevocable.

Recently Issued Accounting Pronouncements

See “Note 1 – Summary of Significant Accounting Policies” to the condensed consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company manages market risk, which, as a financial institution is primarily interest rate volatility, through the Asset-Liability Committee of the Bank, in accordance with policies approved by its board of directors. The Company uses an interest rate risk simulation model and shock analysis to test the interest rate sensitivity of net interest income and fair value of equity, and the impact of changes in interest rates on other financial metrics. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Interest Rate Sensitivity and Market Risk” herein for a discussion of how the Company manages market risk.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures — As of the end of the period covered by this Report, the Company carried out an evaluation, under the supervision and with the participation of its management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply judgment in evaluating its controls and procedures. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act) were effective as of the end of the period covered by this Report.

Changes in internal control over financial reporting — There were no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended September 30, 2019, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Company is not currently subject to any material legal proceedings. The Company is from time to time subject to claims and litigation arising in the ordinary course of business. These claims and litigation may include, among other things, allegations of violation of banking and other applicable regulations, competition law, labor laws and consumer protection laws, as well as claims or litigation relating to intellectual property, securities, breach of contract and tort. The Company intends to defend itself vigorously against any pending or future claims and litigation.

At this time, in the opinion of management, the likelihood is remote that the impact of such proceedings, either individually or in the aggregate, would have a material adverse effect on the Company's consolidated results of operations, financial condition or cash flows. However, one or more unfavorable outcomes in any claim or litigation against us could have a material adverse effect for the period in which they are resolved. In addition, regardless of their merits or their ultimate outcomes, such matters are costly, divert management's attention and may materially and adversely affect the Company's reputation, even if resolved in our favor.

Item 1A. Risk Factors

None.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

In July 2019, the Company's Board of Directors authorized a share repurchase program under which the Company may repurchase up to \$40.0 million of the Company's common stock through September 30, 2020. Repurchases under the program may be made from time to time at the Company's discretion in open market transactions, through block trades, in privately negotiated transactions, and pursuant to any trading plan that may be adopted by the Company's management in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934, as amended, or otherwise. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements, market conditions, and other corporate liquidity requirements and priorities. The repurchase program does not obligate the Company to acquire a specific dollar amount or number of shares and may be modified, suspended or discontinued at any time.

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The following table provides information with respect to purchases of shares of the Company's common stock during the three months ended September 30, 2019 that the Company made or were made on behalf of the Company or any "affiliated purchaser," as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934.

<u>Period</u>	<u>Number of Shares Purchased</u>	<u>Average Price Paid per Share</u>	<u>Number of Shares Purchased as Part of Publicly Announced Plan</u>	<u>Maximum Number of Shares That May Yet be Purchased Under a Plan at the End of the Period ⁽¹⁾</u>
July 1, 2019 - July 31, 2019	-	-	-	-
August 1, 2019 - August 31, 2019	-	-	-	-
September 1, 2019 - September 30, 2019	-	\$ 27.98	100	1,434,620

(1) Computed based on the closing share price of the Company's common stock as of September 30, 2019.

There were no shares repurchased in the three months ended September 30, 2019 resulting from vesting of restricted stock awards.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Other Information

None.

Item 6. Exhibits

<u>Exhibit Number</u>	<u>Description of Exhibit</u>
3.1	First Amended and Restated Certificate of Formation of CBTX, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Form S-1 filed with the Commission on October 13, 2018)
3.2	Second Amended and Restated Bylaws of CBTX, Inc. (incorporated by reference to Exhibit 3.2 to the Company's Form S-1 filed with the Commission on October 13, 2018)
4.1	Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 to the Company's Form S-1 filed with the Commission on October 13, 2018)
31.1*	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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101* The following materials from CBTX's Quarterly Report on Form 10-Q for the quarter ended September 30, 2019, formatted in XBRL (Xtensible Business Reporting Language), filed herewith: (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Operations, (iii) Condensed Consolidated Statements of Comprehensive Income (Loss), (iv) Condensed Consolidated Statements of Changes in Shareholders' Equity, (v) Condensed Consolidated Statements of Cash Flows, and (vi) Notes to Condensed Consolidated Financial Statements.

* Filed with this Quarterly Report on Form 10-Q

** Furnished with this Quarterly Report on Form 10-Q

SIGNATURES

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.

CBTX, INC.
(Registrant)

Date: October 24, 2019

/s/ Robert R. Franklin, Jr.
Robert R. Franklin, Jr.
Chairman, President and Chief Executive Officer
(Principal Executive Officer)

Date: October 24, 2019

/s/ Robert T. Pigott, Jr.
Senior Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

EXHIBIT 31.1

CERTIFICATION

I, Robert R. Franklin, Jr., certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of CBTX, Inc. for the quarter ended September 30, 2019;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 24, 2019

/s/ Robert R. Franklin, Jr.
Robert R. Franklin, Jr.
Chairman, President and Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION

I, Robert T. Pigott, Jr., certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of CBTX, Inc. for the quarter ended September 30, 2019;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 24, 2019

/s/ Robert T. Pigott, Jr.
Robert T. Pigott, Jr.
Senior Executive Vice President and
Chief Financial Officer

Exhibit 32.1

CERTIFICATION

In connection with the Quarterly Report on Form 10-Q of CBTX, Inc. (the "Company") for the quarter ended September 30, 2019 (the "Report"), as filed with the Securities and Exchange Commission on the date hereof, I, Robert R. Franklin, Jr., Chairman, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

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

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

/s/ Robert R. Franklin, Jr.
Robert R. Franklin, Jr.
Chairman, President and Chief Executive Officer
Date: October 24, 2019

Exhibit 32.2

CERTIFICATION

In connection with the Quarterly Report on Form 10-Q of CBTX, Inc. (the "Company") for the quarter ended September 30, 2019 (the "Report"), as filed with the Securities and Exchange Commission on the date hereof, I, Robert T. Pigott, Jr., Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Robert T. Pigott, Jr.
Robert T. Pigott, Jr.
Senior Executive Vice President and
Chief Financial Officer
Date: October 24, 2019
