

GUARANTY BANCSHARES INC /TX/  
Form 10-Q  
November 13, 2017

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, 2017

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: 001-38087

GUARANTY BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

Texas 75-1656431

(State or other jurisdiction of incorporation or organization) (I.R.S. employer identification no.)

201 South Jefferson Avenue  
Mount Pleasant, Texas 75455  
(Address of principal executive offices) (Zip code)

(903) 572 - 9881

(Registrant's telephone number, including area code)

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company  
(Do not check if a 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.

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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 November 13, 2017, there were 11,058,956 outstanding shares of the registrant's common stock, par value \$1.00 per share.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## GUARANTY BANCSHARES, INC.

## CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except share amounts)

|  | (Unaudited)<br>September 30,<br>2017 | (Audited)<br>December 31,<br>2016 |
|--|--------------------------------------|-----------------------------------|
| <b>ASSETS</b>                                  |                                      |                                   |
| Cash and due from banks                        | \$ 33,736                            | \$ 39,605                         |
| Federal funds sold                             | 34,250                               | 60,600                            |
| Interest-bearing deposits                      | 27,075                               | 27,338                            |
| Total cash and cash equivalents                | 95,061                               | 127,543                           |
| Securities available for sale                  | 238,133                              | 156,925                           |
| Securities held to maturity                    | 179,081                              | 189,371                           |
| Loans held for sale                            | 3,400                                | 2,563                             |
| Loans, net                                     | 1,294,847                            | 1,233,651                         |
| Accrued interest receivable                    | 6,440                                | 7,419                             |
| Premises and equipment, net                    | 43,958                               | 44,810                            |
| Other real estate owned                        | 1,929                                | 1,692                             |
| Cash surrender value of life insurance         | 18,376                               | 17,804                            |
| Deferred tax asset                             | 4,267                                | 4,892                             |
| Core deposit intangible, net                   | 2,870                                | 3,308                             |
| Goodwill                                       | 18,742                               | 18,742                            |
| Other assets                                   | 16,949                               | 19,616                            |
| Total assets                                   | \$ 1,924,053                         | \$ 1,828,336                      |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>    |                                      |                                   |
| <b>Liabilities</b>                             |                                      |                                   |
| <b>Deposits</b>                                |                                      |                                   |
| Noninterest-bearing                            | \$ 405,678                           | \$ 358,752                        |
| Interest-bearing                               | 1,211,624                            | 1,218,039                         |
| Total deposits                                 | 1,617,302                            | 1,576,791                         |
| Securities sold under agreements to repurchase | 12,920                               | 10,859                            |
| Accrued interest and other liabilities         | 7,601                                | 6,006                             |
| Other debt                                     | —                                    | 18,286                            |
| Federal Home Loan Bank advances                | 65,157                               | 55,170                            |
| Subordinated debentures                        | 13,810                               | 19,310                            |
| Total liabilities                              | 1,716,790                            | 1,686,422                         |
| <b>Commitments and contingent liabilities</b>  |                                      |                                   |
| KSOP-owned shares                              | —                                    | 31,661                            |

See accompanying notes to consolidated financial statements.

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GUARANTY BANCSHARES, INC.  
CONSOLIDATED BALANCE SHEETS  
(Dollars in thousands, except share amounts)

|   | (Unaudited)<br>September 30,<br>2017 | (Audited)<br>December 31,<br>2016 |
|---|--------------------------------------|-----------------------------------|
| Shareholders' equity  |                                      |                                   |
| Preferred stock, \$5.00 par value, 15,000,000 shares authorized, no shares issued   | —                                    | —                                 |
| Common stock, \$1.00 par value, 50,000,000 shares authorized, 11,921,298 and 9,616,275 shares issued, 11,058,956 and 8,751,923 shares outstanding, respectively | 11,921                               | 9,616                             |
| Additional paid-in capital  | 155,493                              | 101,736                           |
| Retained earnings   | 64,778                               | 57,160                            |
| Treasury stock, 862,342 and 864,352 shares at cost  | (20,087)                             | ) (20,111 )                       |
| Accumulated other comprehensive loss  | (4,842)                              | ) (6,487 )                        |
|   | 207,263                              | 141,914                           |
| Less KSOP-owned shares  | —                                    | 31,661                            |
| Total shareholders' equity  | 207,263                              | 110,253                           |
| Total liabilities and shareholders' equity  | \$ 1,924,053                         | \$ 1,828,336                      |

See accompanying notes to consolidated financial statements.

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GUARANTY BANCSHARES, INC.  
CONSOLIDATED STATEMENTS OF EARNINGS (Unaudited)  
(Dollars in thousands, except per share data)

|   | Three Months<br>Ended<br>September 30, |          | Nine Months<br>Ended September<br>30, |          |
|---|--|----------|---------------------------------------|----------|
|   | 2017                                   | 2016     | 2017                                  | 2016     |
| Interest income                                     |  |          |                                       |          |
| Loans, including fees                               | \$15,486                               | \$14,294 | \$45,115                              | \$40,857 |
| Securities  |  |          |                                       |          |
| Taxable   | 1,545                                  | 1,038    | 4,257                                 | 4,298    |
| Nontaxable  | 919                                    | 923      | 2,761                                 | 2,308    |
| Federal funds sold and interest-bearing deposits    | 215                                    | 172      | 960                                   | 528      |
| Total interest income                               | 18,165                                 | 16,427   | 53,093                                | 47,991   |
| Interest expense                                    |  |          |                                       |          |
| Deposits  | 2,730                                  | 2,329    | 7,761                                 | 6,791    |
| FHLB advances and federal funds purchased           | 157                                    | 109      | 294                                   | 277      |
| Subordinated debentures                             | 164                                    | 217      | 559                                   | 656      |
| Other borrowed money                                | 12                                     | 104      | 337                                   | 452      |
| Total interest expense                              | 3,063                                  | 2,759    | 8,951                                 | 8,176    |
| Net interest income                                 | 15,102                                 | 13,668   | 44,142                                | 39,815   |
| Provision for loan losses                           | 800                                    | 840      | 2,250                                 | 3,240    |
| Net interest income after provision for loan losses | 14,302                                 | 12,828   | 41,892                                | 36,575   |
| Noninterest income                                  |  |          |                                       |          |
| Service charges                                     | 986                                    | 914      | 2,801                                 | 2,625    |
| Net realized gain on securities transactions        | —                                      | 64       | 25                                    | 82       |
| Net realized gain on sale of loans                  | 589                                    | 486      | 1,490                                 | 1,231    |
| Other income  | 2,127                                  | 1,938    | 6,184                                 | 5,664    |
| Total noninterest income                            | 3,702                                  | 3,402    | 10,500                                | 9,602    |
| Noninterest expense                                 |  |          |                                       |          |
| Employee compensation and benefits                  | 6,729                                  | 6,370    | 20,156                                | 19,057   |
| Occupancy expenses                                  | 1,938                                  | 1,720    | 5,552                                 | 5,196    |
| Other expenses                                      | 3,499                                  | 3,390    | 10,409                                | 10,087   |
| Total noninterest expense                           | 12,166                                 | 11,480   | 36,117                                | 34,340   |
| Income before income taxes                          | 5,838                                  | 4,750    | 16,275                                | 11,837   |
| Income tax provision                                | 1,699                                  | 1,380    | 4,644                                 | 3,290    |
| Net earnings  | \$4,139                                | \$3,370  | \$11,631                              | \$8,547  |
| Basic earnings per share                            | \$0.37                                 | \$0.38   | \$1.17                                | \$0.95   |
| Diluted earnings per share                          | \$0.37                                 | \$0.38   | \$1.16                                | \$0.95   |

See accompanying notes to consolidated financial statements.

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GUARANTY BANCSHARES, INC.  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)  
 (Dollars in thousands)

|  | Three Months<br>Ended<br>September 30, |         | Nine Months<br>Ended September<br>30, |          |
|--|--|---------|---------------------------------------|----------|
|  | 2017                                   | 2016    | 2017                                  | 2016     |
| Net earnings   | \$4,139                                | \$3,370 | \$11,631                              | \$8,547  |
| Other comprehensive income:  |  |         |                                       |          |
| Unrealized (losses) gains on securities  |  |         |                                       |          |
| Unrealized holding (losses) gains arising during the period                        | (264 )                                 | (115 )  | 2,422                                 | 3,990    |
| Amortization of net unrealized gains on held to maturity securities                | 23                                     | 48      | 58                                    | 98       |
| Reclassification adjustment for net gains included in net earnings                 | —                                      | (105 )  | (25 )                                 | (123 )   |
| Tax effect   | 92                                     | —       | (839 )                                | (1,083 ) |
| Unrealized (losses) gains on securities, net of tax                                | (149 )                                 | (172 )  | 1,616                                 | 2,882    |
| Unrealized holding gains (losses) arising during the period on interest rate swaps | 35                                     | 34      | 29                                    | (289 )   |
| Total other comprehensive (loss) income  | (114 )                                 | (138 )  | 1,645                                 | 2,593    |
| Comprehensive income   | \$4,025                                | \$3,232 | \$13,276                              | \$11,140 |

See accompanying notes to consolidated financial statements.

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## GUARANTY BANCSHARES, INC.

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)

(Dollars in thousands, except share amounts)

|   | Preferred<br>Stock | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Loss | Less:<br>KSOP-Owned<br>Shares | Total<br>Shareholders'<br>Equity |
|---|--------------------|-----------------|----------------------------------|----------------------|-------------------|---|-------------------------------|----------------------------------|
| For the Nine Months Ended               |                    |                 |                                  |                      |                   |   |                               |                                  |
| September 30, 2016                      |                    |                 |                                  |                      |                   |   |                               |                                  |
| Balance at December 31, 2015            | \$                 | -\$9,616        | \$ 101,525                       | \$49,654             | \$(16,486)        | \$ (6,573 )                                   | \$ (35,384 )                  | \$ 102,352                       |
| Net earnings                            | —                  | —               | —                                | 8,547                | —                 | —   | —                             | 8,547                            |
| Other comprehensive income              | —                  | —               | —                                | —                    | —                 | 2,593   | —                             | 2,593                            |
| Purchase of treasury stock              | —                  | —               | —                                | —                    | (7,261 )          | —   | (3,000 )                      | (10,261 )                        |
| Sale of treasury stock                  | —                  | —               | —                                | —                    | 8,557             | —   | —                             | 8,557                            |
| Stock based compensation                | —                  | —               | 162                              | —                    | —                 | —   | —                             | 162                              |
| Net change in fair value of KSOP shares | —                  | —               | —                                | —                    | —                 | —   | (1,539 )                      | (1,539 )                         |
| Dividends:                              |                    |                 |                                  |                      |                   |   |                               |                                  |
| Common - \$0.26 per share               | —                  | —               | —                                | (2,328 )             | —                 | —   | —                             | (2,328 )                         |
| Balance at September 30, 2016           | \$                 | -\$9,616        | \$ 101,687                       | \$55,873             | \$(15,190)        | \$ (3,980 )                                   | \$ (39,923 )                  | \$ 108,083                       |
| For the Nine Months Ended               |                    |                 |                                  |                      |                   |   |                               |                                  |
| September 30, 2017                      |                    |                 |                                  |                      |                   |   |                               |                                  |
| Balance at December 31, 2016            | \$                 | -\$9,616        | \$ 101,736                       | \$57,160             | \$(20,111)        | \$ (6,487 )                                   | \$ (31,661 )                  | \$ 110,253                       |
| Net earnings                            | —                  | —               | —                                | 11,631               | —                 | —   | —                             | 11,631                           |
| Other comprehensive income              | —                  | —               | —                                | —                    | —                 | 1,645   | —                             | 1,645                            |
| Terminated KSOP put option              | —                  | —               | —                                | —                    | —                 | —   | 34,300                        | 34,300                           |
| Exercise of stock options               | —                  | 5               | 55                               | —                    | 24                | —   | —                             | 84                               |
| Sale of common stock                    | —                  | 2,300           | 53,455                           | —                    | —                 | —   | —                             | 55,755                           |
| Stock based compensation                | —                  | —               | 247                              | —                    | —                 | —   | —                             | 247                              |
| Net change in fair value of KSOP shares | —                  | —               | —                                | —                    | —                 | —   | (2,639 )                      | (2,639 )                         |
| Dividends:                              |                    |                 |                                  |                      |                   |   |                               |                                  |
| Common - \$0.39 per share               | —                  | —               | —                                | (4,013 )             | —                 | —   | —                             | (4,013 )                         |
| Balance at September 30, 2017           | \$                 | -\$11,921       | \$155,493                        | \$64,778             | \$(20,087)        | \$ (4,842 )                                   | \$ —                          | \$ 207,263                       |

See accompanying notes to consolidated financial statements.

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GUARANTY BANCSHARES, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)  
(Dollars in thousands)

|  | For the Nine<br>Months Ended<br>September 30, |           |
|--|---|-----------|
|  | 2017  | 2016      |
| Cash flows from operating activities   |   |           |
| Net earnings   | \$11,631                                      | \$8,547   |
| Adjustments to reconcile net earnings to net cash provided from operating activities:    |   |           |
| Depreciation   | 2,385   | 2,262     |
| Amortization   | 782   | 779       |
| Deferred taxes   | (214 )  | (1,228 )  |
| Premium amortization, net of discount accretion  | 3,581   | 3,528     |
| Net realized gain on securities transactions   | (25 )   | (82 )     |
| Gain on sale of loans  | (1,490 )                                      | (1,231 )  |
| Provision for loan losses  | 2,250   | 3,240     |
| Origination of loans held for sale   | (50,230 )                                     | (43,146 ) |
| Proceeds from loans held for sale  | 50,883  | 45,158    |
| Write-down of other real estate and repossessed assets                                   | 9   | 107       |
| Net loss (gain) on sale of premises, equipment, other real estate owned and other assets | 111   | (1,214 )  |
| Stock based compensation   | 247   | 162       |
| Net change in accrued interest receivable and other assets                               | 1,680   | (1,633 )  |
| Net change in accrued interest payable and other liabilities                             | 1,624   | 1,342     |
| Net cash provided by operating activities  | 23,224  | 16,591    |
| Cash flows from investing activities   |   |           |
| Securities available for sale:   |   |           |
| Purchases  | (313,177)                                     | (26,140)  |
| Proceeds from sales  | 213,813                                       | 103,942   |
| Proceeds from maturities and principal repayments  | 18,925  | 54,021    |
| Securities held to maturity:   |   |           |
| Purchases  | —   | (86,642)  |
| Proceeds from sales  | 923   | 1,866     |
| Proceeds from maturities and principal repayments  | 7,497   | 15,121    |
| Acquisition of Denton branch, net of cash paid   | —   | 2,399     |
| Net purchases of premises and equipment  | (1,678 )                                      | (634 )    |
| Net proceeds from sale of premises, equipment, other real estate owned and other assets  | 1,830   | 2,826     |
| Net increase in loans  | (64,438 )                                     | (168,154) |
| Net cash used in investing activities  | (136,305)                                     | (101,395) |
| Cash flows from financing activities   |   |           |
| Net change in deposits   | 40,511  | 64,536    |
| Net change in securities sold under agreements to repurchase                             | 2,061   | (254 )    |
| Proceeds from FHLB advances  | 60,000  | 120,178   |
| Repayment of FHLB advances   | (50,013 )                                     | (81,346)  |
| Proceeds from other debt   | 2,000   | 10,000    |
| Repayment of other debt  | (20,286 )                                     | (18,357)  |
| Repayments of debentures   | (5,500 )                                      | (1,000 )  |

|                            |   |          |
|----------------------------|---|----------|
| Purchase of treasury stock | — | (7,261 ) |
|----------------------------|---|----------|

See accompanying notes to consolidated financial statements.

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GUARANTY BANCSHARES, INC.  
 CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)  
 (Dollars in thousands)

|   | For the Nine Months<br>Ended September<br>30, |            |
|---|---|------------|
|   | 2017  | 2016       |
| Sale of treasury stock  | —   | 8,557      |
| Exercise of stock options   | 84  | —          |
| Sale of common stock  | 55,755  | —          |
| Cash dividends  | (4,013 )                                      | (2,329 )   |
| Net cash provided by financing activities                           | 80,599  | 92,724     |
| Net change in cash and cash equivalents                             | (32,482 )                                     | 7,920      |
| Cash and cash equivalents at beginning of period                    | 127,543                                       | 111,379    |
| Cash and cash equivalents at end of period                          | \$95,061                                      | \$ 119,299 |
| Supplemental disclosures of cash flow information                   |   |            |
| Interest paid   | \$8,958                                       | \$ 1,839   |
| Income taxes paid   | 4,910   | 4,610      |
| Supplemental schedule of noncash investing and financing activities |   |            |
| Transfer loans to other real estate owned and repossessed assets    | \$992   | \$5,862    |
| Terminated KSOP put option  | 34,300  | —          |
| Net change in fair value of KSOP shares                             | 2,639   | 1,539      |

See accompanying notes to consolidated financial statements.

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GUARANTY BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations: Guaranty Bancshares, Inc. (“Guaranty”) is a bank holding company headquartered in Mount Pleasant, Texas that provides, through its wholly-owned subsidiary, Guaranty Bank & Trust, N.A. (the “Bank”), a broad array of financial products and services to individuals and corporate customers, primarily in its markets of East Texas, Bryan/College Station and the Dallas/Fort Worth metroplex. The terms “the Company,” “we,” “us” and “our” mean Guaranty and its subsidiaries, when appropriate. The Company’s main sources of income are derived from granting loans throughout its markets and investing in securities issued by the U.S. Treasury, U.S. government agencies and state and political subdivisions. The Company’s primary lending products are real estate, commercial and consumer loans. Although the Company has a diversified loan portfolio, a substantial portion of its debtors’ abilities to honor contracts is dependent on the economy of the State of Texas and primarily the economies of East Texas, Bryan/College Station and the Dallas/Fort Worth metroplex. The Company primarily funds its lending activities with deposit operations. The Company’s primary deposit products are checking accounts, money market accounts and certificates of deposit.

Basis of Presentation: The consolidated financial statements in this Quarterly Report on Form 10-Q (this “Report”) include the accounts of Guaranty, the Bank, and their respective other direct and indirect subsidiaries and any other entities in which Guaranty has a controlling interest. The Bank has five wholly-owned non-bank subsidiaries, Guaranty Company, Inc., G B COM, INC., 2800 South Texas Avenue LLC, Pin Oak Realty Holdings, Inc. and Pin Oak Energy Holdings, LLC. All significant intercompany balances and transactions have been eliminated in consolidation. The accounting and financial reporting policies followed by the Company conform, in all material respects, to accounting principles generally accepted in the United States of America (“GAAP”) and to general practices within the financial services industry.

The consolidated financial statements in this Report have not been audited by an independent registered public accounting firm, but in the opinion of management, reflect all adjustments necessary for a fair presentation of the Company’s financial position and results of operations. All such adjustments were of a normal and recurring nature. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission (“SEC”). Accordingly, the financial statements do not include all of the information and footnotes required by GAAP for complete financial statements and should be read in conjunction with the Company’s consolidated financial statements, and notes thereto, for the year ended December 31, 2016, included in the Guaranty’s Prospectus filed with the SEC under Rule 424(b) on May 9, 2017, relating to its initial public offering. Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period.

All dollar amounts referenced and discussed in the notes to the consolidated financial statements in this Report are presented in thousands, unless noted otherwise.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. These estimates and assumptions may also affect disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

KSOP Repurchase Right: In accordance with applicable provisions of the Internal Revenue Code, the terms of Guaranty’s employee stock ownership plan with 401(k) provisions (“KSOP”), provided that, for so long as Guaranty was a privately-held company without a public market for its common stock, KSOP participants would have the right, for

a specified period of time, to require Guaranty to repurchase shares of its common stock that are distributed to them by the KSOP. This repurchase obligation terminated upon the consummation of Guaranty's initial public offering and listing of its common stock on the NASDAQ Global Select Market in May 2017. However, because Guaranty was privately-held without a public market for its common stock as of and for the year ended December 31, 2016, the shares of common stock held by the KSOP are reflected in the Company's consolidated balance sheet as of December 31, 2016 as a line item called "KSOP-owned shares," appearing between total liabilities and shareholders' equity. As a result, the KSOP-owned shares are deducted from shareholders' equity in the Company's consolidated balance sheet

(Continued)

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GUARANTY BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

as of December 31, 2016. For all periods following Guaranty's initial public offering and continued listing of the Company's common stock on the NASDAQ Global Select Market, the KSOP-owned shares will be included in, and not be deducted from, shareholders' equity. The termination of the repurchase obligation following the listing of Guaranty's common stock on the NASDAQ Global Select Market is also reflected in the statement of changes in shareholders' equity as "terminated KSOP put option."

Recent Accounting Pronouncements:

In January 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business. This ASU is intended to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. In addition, the amendments in this ASU provide a detailed framework to assist entities in evaluating whether a set of assets and activities constitutes a business, as well as clarify the definition of the term output so the term is consistent with how outputs are described in Topic 606. ASU 2017-01 is effective for public companies for annual periods beginning after December 15, 2017, including interim periods within those periods. The Company does not expect this pronouncement to have a significant impact on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. This ASU simplifies the accounting for goodwill impairment for all entities by requiring impairment changes to be based on the first step in today's two-step impairment test, thus eliminating step two from the goodwill impairment test. In addition, the amendment eliminates the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform step two of the goodwill impairment test. For public companies, ASU 2017-04 is effective for fiscal years beginning after December 15, 2019 with early adoption permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company is in the process of evaluating the impact of this pronouncement, which is not expected to have a significant impact on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires that the statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. For public companies, ASU 2016-18 is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. The Company is in the process of evaluating the impact of this pronouncement, which is not expected to have a significant impact on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, to address diversity in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments provide guidance on the following nine specific cash flow issues: 1) debt prepayment or debt extinguishment costs; 2) settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; 3) contingent consideration payments made after a business combination; 4) proceeds from the settlement of insurance claims; 5) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned; 6) life insurance policies; 7) distributions received from equity method investees; 8) beneficial interests in securitization transactions; and 9) separately identifiable cash flows and application of the predominance principle. The amendments are effective for public companies for fiscal years beginning after December 31, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The Company does not expect the adoption of this guidance to be material to its consolidated financial statements.



In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which sets forth a "current expected credit loss" ("CECL") model requiring the Company to measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions and reasonable supportable forecasts. This replaces the existing incurred loss model and is applicable to the measurement of credit losses on financial assets measured at amortized cost and applies to some off-balance sheet credit exposures. For public companies, the amendments in this update are effective for fiscal

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years beginning after December 15, 2019, including interim periods within those fiscal years. The Company has assembled a transition team to assess the adoption of this ASU, and has developed a project plan regarding implementation.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The FASB issued this ASU to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet by lessees for those leases classified as operating leases under current U.S. GAAP and disclosing key information about leasing arrangements. The amendments in this ASU are effective for public companies for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. Early adoption of this ASU is permitted for all entities. The Company is currently evaluating the impact of adopting the new guidance on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities, which is intended to improve the recognition and measurement of financial instruments by requiring: equity investments (other than equity method or consolidation) to be measured at fair value with changes in fair value recognized in net income; public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; eliminating the requirement to disclose the fair value of financial instruments measured at amortized cost for organizations that are not public business entities; eliminating the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; and requiring a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk (also referred to as “own credit”) when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. This ASU is effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. This ASU permits early adoption of the instrument-specific credit risk provision. The Company is in the process of evaluating the impact of this pronouncement, which is not expected to have a significant impact on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), followed by various amendments: ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, ASU 2016-11, Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting, and ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients. The amendments in these updates amend existing guidance related to revenue from contracts with customers. The amendments supersede and replace nearly all existing revenue recognition guidance, including industry-specific guidance, establish a new control-based revenue recognition model, change the basis for deciding when revenue is recognized over a time or point in time, provide new and more detailed guidance on specific topics and expand and improve disclosures about revenue. In addition, these amendments specify the accounting for some costs to obtain or fulfill a contract with a customer. The amendments are effective for annual and interim periods beginning after December 15, 2017, and must be retrospectively applied. The majority of the Company's income consists of net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of the amendments. The Company continues to

evaluate the impact of the amendments on the components of noninterest income that have recurring revenue streams; however, the Company does not expect any recognition changes to have a significant impact to its consolidated financial statements.

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## NOTE 2 - ACQUISITIONS

On August 6, 2016, the Company purchased certain assets and assumed certain liabilities associated with a former branch location of a non-related bank in Denton, Texas (Denton), which resulted in the addition of approximately \$4,659 in assets and the assumption of approximately \$4,658 in liabilities. The Company acquired the bank premises at 4101 Wind River Lane in Denton and recorded it at fair market value of \$2,075. Other assets acquired, at fair value, included cash of \$2,399, core deposit intangible of \$42, goodwill of \$141 and loans of \$2. Liabilities assumed included non-interest bearing deposits of \$581, interest bearing deposits of \$4,047 and other liabilities of \$30. As a result of the transaction, the Company paid \$66 to the seller, representing the difference in the value of the acquired assets less the value of the liabilities assumed by the Company in the transaction.

Goodwill of \$141 arising from the Denton acquisition consisted largely of synergies and the cost savings resulting from the combining of the operations of the companies and is expected to be deductible for income taxes purposes.

## NOTE 3 - MARKETABLE SECURITIES

The following tables summarize the amortized cost and fair value of securities available for sale and securities held to maturity as of September 30, 2017 and December 31, 2016 and the corresponding amounts of gross unrealized gains and losses:

| September 30, 2017                  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
|-------------------------------------|-------------------|------------------------------|-------------------------------|----------------------------|
| Available for sale:                 |                   |                              |                               |                            |
| Corporate bonds                     | \$ 18,842         | \$ 178                       | \$ —                          | \$ 19,020                  |
| Municipal securities                | 7,769             | —                            | 305                           | 7,464                      |
| Mortgage-backed securities          | 91,801            | 20                           | 863                           | 90,958                     |
| Collateralized mortgage obligations | 120,580           | 493                          | 382                           | 120,691                    |
| Total available for sale            | \$ 238,992        | \$ 691                       | \$ 1,550                      | \$ 238,133                 |
| Held to maturity:                   |                   |                              |                               |                            |
| Municipal securities                | \$ 146,993        | \$ 2,696                     | \$ 516                        | \$ 149,173                 |
| Mortgage-backed securities          | 23,337            | 278                          | 66                            | 23,549                     |
| Collateralized mortgage obligations | 8,751             | 181                          | 503                           | 8,429                      |
| Total held to maturity              | \$ 179,081        | \$ 3,155                     | \$ 1,085                      | \$ 181,151                 |

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| December 31, 2016                   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
|-------------------------------------|-------------------|------------------------------|-------------------------------|----------------------------|
| Available for sale:                 |                   |                              |                               |                            |
| Corporate bonds                     | \$ 25,254         | \$ 6                         | \$ 377                        | \$24,883                   |
| Municipal securities                | 7,841             | —                            | 622                           | 7,219                      |
| Mortgage-backed securities          | 61,298            | —                            | 1,608                         | 59,690                     |
| Collateralized mortgage obligations | 65,789            | 10                           | 666                           | 65,133                     |
| Total available for sale            | \$ 160,182        | \$ 16                        | \$ 3,273                      | \$ 156,925                 |
| Held to maturity:                   |                   |                              |                               |                            |
| Municipal securities                | \$ 149,420        | \$ 901                       | \$ 3,889                      | \$ 146,432                 |
| Mortgage-backed securities          | 28,450            | 318                          | 290                           | 28,478                     |
| Collateralized mortgage obligations | 11,501            | 265                          | 521                           | 11,245                     |
| Total held to maturity              | \$ 189,371        | \$ 1,484                     | \$ 4,700                      | \$ 186,155                 |

The Company's held to maturity mortgage-backed securities portfolio includes non-agency collateralized mortgage obligations with a carrying value of \$1,470, which had unrealized losses of \$503 as of September 30, 2017. These non-agency mortgage-backed securities were rated AAA at purchase. The Company monitors these securities to ensure it has adequate credit support, and the Company records other than temporary impairment (OTTI) as appropriate. The Company does not have the intent to sell these securities and does not expect to sell the securities before their anticipated recovery.

Management evaluates securities for OTTI on at least a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The Company did not record any OTTI losses on any of its securities during the nine months ended September 30, 2017 or for the year ended December 31, 2016.

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Information pertaining to securities with gross unrealized losses as of September 30, 2017 and December 31, 2016 aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position is detailed in the following tables:

|                                     | Less Than 12 Months     |                      | 12 Months or Longer     |                      | Total                   |                      |
|-------------------------------------|-------------------------|----------------------|-------------------------|----------------------|-------------------------|----------------------|
|                                     | Gross Unrealized Losses | Estimated Fair Value | Gross Unrealized Losses | Estimated Fair Value | Gross Unrealized Losses | Estimated Fair Value |
| September 30, 2017                  |                         |                      |                         |                      |                         |                      |
| Available for sale:                 |                         |                      |                         |                      |                         |                      |
| Corporate bonds                     | \$—                     | \$—                  | \$—                     | \$—                  | \$—                     | \$—                  |
| Municipal securities                | —                       | —                    | (305)                   | 7,464                | (305)                   | 7,464                |
| Mortgage-backed securities          | (556)                   | 72,802               | (307)                   | 13,913               | (863)                   | 86,715               |
| Collateralized mortgage obligations | (244)                   | 42,825               | (138)                   | 7,522                | (382)                   | 50,347               |
| Total available for sale            | \$(800)                 | \$115,627            | \$(750)                 | \$28,899             | \$(1,550)               | \$144,526            |
| Held to maturity:                   |                         |                      |                         |                      |                         |                      |
| Municipal securities                | \$(258)                 | \$39,090             | \$(258)                 | \$13,085             | \$(516)                 | \$52,175             |
| Mortgage-backed securities          | (66)                    | 10,562               | —                       | —                    | (66)                    | 10,562               |
| Collateralized mortgage obligations | —                       | —                    | (503)                   | 2,272                | (503)                   | 2,272                |
| Total held to maturity              | \$(324)                 | \$49,652             | \$(761)                 | \$15,357             | \$(1,085)               | \$65,009             |
| December 31, 2016                   |                         |                      |                         |                      |                         |                      |
| Available for sale:                 |                         |                      |                         |                      |                         |                      |
| Corporate bonds                     | \$(377)                 | \$22,529             | \$—                     | \$—                  | \$(377)                 | \$22,529             |
| Municipal securities                | (622)                   | 7,219                | —                       | —                    | (622)                   | 7,219                |
| Mortgage-backed securities          | (1,047)                 | 44,420               | (561)                   | 15,270               | (1,608)                 | 59,690               |
| Collateralized mortgage obligations | (437)                   | 55,435               | (229)                   | 9,049                | (666)                   | 64,484               |
| Total available for sale            | \$(2,483)               | \$129,603            | \$(790)                 | \$24,319             | \$(3,273)               | \$153,922            |
| Held to maturity:                   |                         |                      |                         |                      |                         |                      |
| Municipal securities                | \$(3,889)               | \$98,943             | \$—                     | \$—                  | \$(3,889)               | \$98,943             |
| Mortgage-backed securities          | (290)                   | 19,983               | —                       | —                    | (290)                   | 19,983               |
| Collateralized mortgage obligations | —                       | —                    | (521)                   | 2,350                | (521)                   | 2,350                |
| Total held to maturity              | \$(4,179)               | \$118,926            | \$(521)                 | \$2,350              | \$(4,700)               | \$121,276            |

The number of investment positions in an unrealized loss position totaled 104 and 177 at September 30, 2017 and December 31, 2016, respectively. The securities in a loss position were composed of tax-exempt municipal bonds, corporate bonds, collateralized mortgage obligations and mortgage backed securities. Management believes the unrealized loss on the remaining securities is a function of the movement of interest rates since the time of purchase. Based on evaluation of available evidence, including recent changes in interest rates, credit rating information and

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information obtained from regulatory filings, management believes the declines in fair value for these securities are temporary. Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment would be reduced and the resulting loss recognized in net income in the period the OTTI is identified. The Company does not have the intent to sell these mortgage-backed securities and it is likely that it will not be required to sell the securities before their anticipated recovery. The Company does not consider these securities to be OTTI at September 30, 2017.

Mortgage-backed securities and collateralized mortgage obligations are backed by pools of mortgages that are insured or guaranteed by the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association or the Government National Mortgage Association.

As of September 30, 2017, there were no holdings of securities of any one issuer, other than the U.S. government and its agencies, in an amount greater than 10% of shareholders' equity.

Securities with fair values of approximately \$221,777 and \$259,499 at September 30, 2017 and December 31, 2016, respectively, were pledged to secure public fund deposits and for other purposes as required or permitted by law.

The proceeds from sales of securities and the associated gains and losses are listed below for:

|              | Three Months<br>Ended September<br>30, |           | Nine Months Ended<br>September 30, |            |
|--------------|--|-----------|------------------------------------|------------|
|              | 2017                                   | 2016      | 2017                               | 2016       |
| Proceeds     | \$ 199,974                             | \$ 31,969 | \$ 214,736                         | \$ 109,056 |
| Gross gains  | —                                      | 96        | 38                                 | 243        |
| Gross losses | —                                      | (32)      | (13)                               | (161)      |

During the nine months ended September 30, 2017 and 2016, the Company sold three held-to-maturity securities each year. The Company sold these municipal securities based upon internal credit analysis, under the belief that they had experienced significant deterioration in creditworthiness. The risk exposure presented by these municipalities had increased beyond acceptable levels, and the Company determined that it was reasonably possible that all amounts due would not be collected. The credit analysis determined that the municipalities had been significantly impacted because their tax bases are heavily reliant on the energy industry relative to other sectors of the economy. Specifically, the revenues of these municipalities have been adversely impacted by the significant decline in energy prices since 2014. The Company believes the sale of these securities were merited and permissible under the applicable accounting guidelines because of the significant deterioration in the creditworthiness of the issuers.

Sale of securities held to maturity were as follows for:

|                      | Three<br>Months<br>Ended<br>September<br>30, |      | Nine Months<br>Ended<br>September 30, |          |
|----------------------|--|------|---------------------------------------|----------|
|                      | 2017   | 2016 | 2017                                  | 2016     |
| Proceeds from sales  | \$ —   | \$ — | \$ 923                                | \$ 1,866 |
| Amortized cost       | —  | —    | 907                                   | 1,842    |
| Gross realized gains | —  | —    | 16                                    | 24       |



Tax expense related to securities gains/losses — — (4 ) (7 )

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The contractual maturities at September 30, 2017 of available for sale and held to maturity securities at carrying value and estimated fair value are shown below. The Company invests in mortgage-backed securities and collateralized mortgage obligations that have expected maturities that differ from their contractual maturities. These differences arise because borrowers and/or issuers may have the right to call or prepay their obligation with or without call or prepayment penalties.

|  | Available for Sale |                            | Held to Maturity  |                            |
|--|--------------------|----------------------------|-------------------|----------------------------|
|  | Amortized<br>Cost  | Estimated<br>Fair<br>Value | Amortized<br>Cost | Estimated<br>Fair<br>Value |
| Due within one year                    | \$—                | \$—                        | \$2,683           | \$2,693                    |
| Due after one year through five years  | 1,086              | 1,096                      | 5,126             | 5,292                      |
| Due after five years through ten years | 17,756             | 17,924                     | 43,228            | 44,785                     |
| Due after ten years                    | 7,769              | 7,464                      | 95,956            | 96,403                     |
| Mortgage-backed securities             | 91,801             | 90,958                     | 23,337            | 23,549                     |
| Collateralized mortgage obligations    | 120,580            | 120,691                    | 8,751             | 8,429                      |
| Total Securities                       | \$238,992          | \$238,133                  | \$179,081         | \$181,151                  |

## NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES

The following table summarizes the Company's loan portfolio by type of loan as of:

|                              | September 30, December 31, |              |
|------------------------------|----------------------------|--------------|
|                              | 2017                       | 2016         |
| Commercial and industrial    | \$ 192,663                 | \$ 223,997   |
| Real estate:                 |                            |              |
| Construction and development | 201,067                    | 129,366      |
| Commercial real estate       | 393,314                    | 367,656      |
| Farmland                     | 54,349                     | 62,362       |
| 1-4 family residential       | 365,889                    | 362,952      |
| Multi-family residential     | 23,235                     | 26,079       |
| Consumer                     | 51,711                     | 53,505       |
| Agricultural                 | 24,449                     | 18,901       |
| Overdrafts                   | 698                        | 317          |
| Total loans                  | 1,307,375                  | 1,245,135    |
| Less:                        |                            |              |
| Allowance for loan losses    | 12,528                     | 11,484       |
| Total net loans              | \$ 1,294,847               | \$ 1,233,651 |

As of September 30, 2017 and December 31, 2016, included in total loans above were \$1,089 and \$1,210 in unamortized loan costs, net of loan fees, respectively.

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The following tables present the activity in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method for the nine months ended September 30, 2017, for the year ended December 31, 2016 and for the nine months ended September 30, 2016:

For the nine

| months<br>ended<br>September<br>30, 2017       | Commercial<br>and<br>industrial | Construction<br>and<br>development | Commercial<br>real<br>estate | Farmland | 1-4 family<br>residential | Multi-family<br>residential | Consumer | Agriculture | Overdraft | Total       |
|--|---------------------------------|------------------------------------|------------------------------|----------|---------------------------|-----------------------------|----------|-------------|-----------|-------------|
| Allowance<br>for loan<br>losses:               |                                 |                                    |                              |          |                           |                             |          |             |           |             |
| Beginning<br>balance                           | \$1,592                         | \$1,161                            | \$3,264                      | \$482    | \$3,960                   | \$281                       | \$585    | \$153       | \$6       | \$11,484    |
| Provision<br>for loan<br>losses                | 602                             | 762                                | 1,019                        | (24)     | (585)                     | (15)                        | 149      | 258         | 84        | 2,250       |
| Loans<br>charged-off                           | (737)                           | —                                  | (84)                         | —        | (307)                     | —                           | (230)    | (4)         | (117)     | (1,479)     |
| Recoveries                                     | 116                             | —                                  | —                            | —        | 21                        | —                           | 95       | —           | 41        | 273         |
| Ending<br>balance                              | \$1,573                         | \$1,923                            | \$4,199                      | \$458    | \$3,089                   | \$266                       | \$599    | \$407       | \$14      | \$12,528    |
| Allowance<br>ending<br>balance:                |                                 |                                    |                              |          |                           |                             |          |             |           |             |
| Individually<br>evaluated<br>for<br>impairment | \$19                            | \$—                                | \$31                         | \$85     | \$145                     | \$—                         | \$—      | \$240       | \$—       | \$520       |
| Collectively<br>evaluated<br>for<br>impairment | 1,554                           | 1,923                              | 4,168                        | 373      | 2,944                     | 266                         | 599      | 167         | 14        | 12,008      |
| Ending<br>balance                              | \$1,573                         | \$1,923                            | \$4,199                      | \$458    | \$3,089                   | \$266                       | \$599    | \$407       | \$14      | \$12,528    |
| Loans:   |                                 |                                    |                              |          |                           |                             |          |             |           |             |
| Individually<br>evaluated<br>for<br>impairment | \$354                           | \$—                                | \$4,029                      | \$276    | \$1,097                   | \$228                       | \$—      | \$696       | \$—       | \$6,680     |
| Collectively<br>evaluated<br>for<br>impairment | 192,309                         | 201,067                            | 389,285                      | 54,073   | 364,792                   | 23,007                      | 51,711   | 23,753      | 698       | 1,300,695   |
| Ending<br>balance                              | \$192,663                       | \$201,067                          | \$393,314                    | \$54,349 | \$365,889                 | \$23,235                    | \$51,711 | \$24,449    | \$698     | \$1,307,375 |

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| For the year ended December 31, 2016  | Commercial and industrial | Construction and development | Commercial real estate | Farmland | 1-4 family residential | Multi-family residential | Consumer | Agriculture | Overdraft | Total       |
|---------------------------------------|---------------------------|------------------------------|------------------------|----------|------------------------|--------------------------|----------|-------------|-----------|-------------|
| Allowance for loan losses:            |                           |                              |                        |          |                        |                          |          |             |           |             |
| Beginning balance                     | \$1,878                   | \$1,004                      | \$2,106                | \$400    | \$2,839                | \$325                    | \$562    | \$138       | \$11      | \$9,263     |
| Provision for loan losses             | 910                       | 162                          | 1,158                  | 82       | 1,117                  | (44)                     | 171      | 15          | 69        | 3,640       |
| Loans charged-off                     | (1,213)                   | (9)                          | —                      | —        | (71)                   | —                        | (269)    | —           | (200)     | (1,762)     |
| Recoveries                            | 17                        | 4                            | —                      | —        | 75                     | —                        | 121      | —           | 126       | 343         |
| Ending balance                        | \$1,592                   | \$1,161                      | \$3,264                | \$482    | \$3,960                | \$281                    | \$585    | \$153       | \$6       | \$11,484    |
| Allowance ending balance:             |                           |                              |                        |          |                        |                          |          |             |           |             |
| Individually evaluated for impairment | \$64                      | \$—                          | \$—                    | \$47     | \$108                  | \$—                      | \$34     | \$—         | \$—       | \$253       |
| Collectively evaluated for impairment | 1,528                     | 1,161                        | 3,264                  | 435      | 3,852                  | 281                      | 551      | 153         | 6         | 11,231      |
| Ending balance                        | \$1,592                   | \$1,161                      | \$3,264                | \$482    | \$3,960                | \$281                    | \$585    | \$153       | \$6       | \$11,484    |
| Loans:                                |                           |                              |                        |          |                        |                          |          |             |           |             |
| Individually evaluated for impairment | \$231                     | \$1,825                      | \$1,196                | \$258    | \$2,588                | \$5                      | \$200    | \$15        | \$—       | \$6,318     |
| Collectively evaluated for impairment | 223,766                   | 127,541                      | 366,460                | 62,104   | 360,364                | 26,074                   | 53,305   | 18,886      | 317       | 1,238,817   |
| Ending balance                        | \$223,997                 | \$129,366                    | \$367,656              | \$62,362 | \$362,952              | \$26,079                 | \$53,505 | \$18,901    | \$317     | \$1,245,135 |

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| For the nine<br>months<br>ended<br>September<br>30, 2016 | Commercial<br>and<br>industrial | Construction<br>and<br>development | Commercial<br>real<br>estate | Farmland  | 1-4 family<br>residential | Multi-family<br>residential | Consumer  | Agriculture | Overdraft | Total        |
|--|---------------------------------|------------------------------------|------------------------------|-----------|---------------------------|-----------------------------|-----------|-------------|-----------|--------------|
| Allowance<br>for loan<br>losses:                         |                                 |                                    |                              |           |                           |                             |           |             |           |              |
| Beginning<br>balance                                     | \$ 1,878                        | \$ 1,004                           | \$ 2,106                     | \$ 400    | \$ 2,839                  | \$ 325                      | \$ 562    | \$ 138      | \$ 11     | \$ 9,263     |
| Provision<br>for loan<br>losses                          | 949                             | 134                                | 993                          | 74        | 916                       | 46                          | 74        | (10 )       | 64        | 3,240        |
| Loans<br>charged-off                                     | (1,196 )                        | (9 )                               | —                            | —         | (25 )                     | —                           | (170 )    | —           | (119 )    | (1,519 )     |
| Recoveries   | 14                              | 4                                  | —                            | —         | —                         | —                           | 103       | —           | 61        | 182          |
| Ending<br>balance  | \$ 1,645                        | \$ 1,133                           | \$ 3,099                     | \$ 474    | \$ 3,730                  | \$ 371                      | \$ 569    | \$ 128      | \$ 17     | \$ 11,166    |
| Allowance<br>ending<br>balance:                          |                                 |                                    |                              |           |                           |                             |           |             |           |              |
| Individually<br>evaluated<br>for<br>impairment           | \$ 139                          | \$ —                               | \$ —                         | \$ 47     | \$ 82                     | \$ —                        | \$ 29     | \$ 1        | \$ —      | \$ 298       |
| Collectively<br>evaluated<br>for<br>impairment           | 1,506                           | 1,133                              | 3,099                        | 427       | 3,648                     | 371                         | 540       | 127         | 17        | 10,868       |
| Ending<br>balance  | \$ 1,645                        | \$ 1,133                           | \$ 3,099                     | \$ 474    | \$ 3,730                  | \$ 371                      | \$ 569    | \$ 128      | \$ 17     | \$ 11,166    |
| Loans:   |                                 |                                    |                              |           |                           |                             |           |             |           |              |
| Individually<br>evaluated<br>for<br>impairment           | \$ 236                          | \$ —                               | \$ 1,464                     | \$ 259    | \$ 2,177                  | \$ —                        | \$ 208    | \$ 319      | \$ —      | \$ 4,663     |
| Collectively<br>evaluated<br>for<br>impairment           | 224,381                         | 125,045                            | 359,212                      | 61,643    | 346,224                   | 34,538                      | 54,137    | 18,904      | 594       | 1,224,678    |
| Ending<br>balance  | \$ 224,617                      | \$ 125,045                         | \$ 360,676                   | \$ 61,902 | \$ 348,401                | \$ 34,538                   | \$ 54,345 | \$ 19,223   | \$ 594    | \$ 1,229,341 |

Credit Quality

The Company closely monitors economic conditions and loan performance trends to manage and evaluate the exposure to credit risk. Key factors tracked by the Company and utilized in evaluating the credit quality of the loan portfolio include trends in delinquency ratios, the level of nonperforming assets, borrower's repayment capacity, and collateral coverage.

Assets are graded "pass" when the relationship exhibits acceptable credit risk and indicates repayment ability, tolerable collateral coverage and reasonable performance history. Lending relationships exhibiting potentially significant credit risk and marginal repayment ability and/or asset protection are graded "special mention." Assets classified as "substandard" are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness that jeopardizes the liquidation of the debt. Substandard graded loans are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Assets graded "doubtful" are substandard graded loans that have added characteristics that make collection or liquidation in full improbable. The Company typically measures impairment based on the present value of expected future cash flows, discounted at the loan's effective interest rate, or based on the loan's observable market price or the fair value of the collateral if the loan is collateral-dependent.

The following tables summarize the credit exposure in the Company's consumer and commercial loan portfolios as of:

| September 30,<br>2017 | Commercial<br>and<br>industrial | Construction<br>and<br>development | Commercial<br>real<br>estate | Farmland  | 1-4<br>family<br>residential | Multi-family<br>residential | Consumer<br>and<br>Overdrafts | Agricultural | Total        |
|-----------------------|---------------------------------|------------------------------------|------------------------------|-----------|------------------------------|-----------------------------|-------------------------------|--------------|--------------|
| Grade:                |                                 |                                    |                              |           |                              |                             |                               |              |              |
| Pass                  | \$ 188,440                      | \$ 181,879                         | \$ 388,007                   | \$ 53,649 | \$ 357,814                   | \$ 21,659                   | \$ 51,631                     | \$ 22,525    | \$ 1,265,604 |
| Special mention       | 3,705                           | 19,188                             | 1,030                        | 413       | 3,059                        | 1,348                       | 362                           | 1,147        | 30,252       |
| Substandard           | 518                             | —                                  | 4,277                        | 287       | 5,016                        | 228                         | 416                           | 777          | 11,519       |
| Total                 | \$ 192,663                      | \$ 201,067                         | \$ 393,314                   | \$ 54,349 | \$ 365,889                   | \$ 23,235                   | \$ 52,409                     | \$ 24,449    | \$ 1,307,375 |

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GUARANTY BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

| December 31,<br>2016 | Commercial<br>and<br>industrial | Construction<br>and<br>development | Commercial<br>real<br>estate | Farmland  | 1-4<br>family<br>residential | Multi-family<br>residential | Consumer<br>and<br>Overdrafts | Agricultural | Total        |
|----------------------|---------------------------------|------------------------------------|------------------------------|-----------|------------------------------|-----------------------------|-------------------------------|--------------|--------------|
| Grade:               |                                 |                                    |                              |           |                              |                             |                               |              |              |
| Pass                 | \$ 218,975                      | \$ 127,537                         | \$ 360,264                   | \$ 61,713 | \$ 353,483                   | \$ 25,871                   | \$ 52,648                     | \$ 17,965    | \$ 1,218,456 |
| Special mention      | 4,299                           | 4                                  | 1,927                        | 248       | 4,311                        | —                           | 524                           | 478          | 11,791       |
| Substandard          | 706                             | 1,825                              | 5,465                        | 401       | 5,121                        | 208                         | 568                           | 458          | 14,752       |
| Doubtful             | 17                              | —                                  | —                            | —         | 37                           | —                           | 82                            | —            | 136          |
| Total                | \$ 223,997                      | \$ 129,366                         | \$ 367,656                   | \$ 62,362 | \$ 362,952                   | \$ 26,079                   | \$ 53,822                     | \$ 18,901    | \$ 1,245,135 |

The following tables summarize the payment status of loans in the Company's total loan portfolio, including an aging of delinquent loans, loans 90 days or more past due continuing to accrue interest and loans classified as nonperforming as of:

| September 30, 2017           | 30 to 59<br>Days<br>Past<br>Due | 60 to 89<br>Days<br>Past<br>Due | 90 Days<br>and Greater<br>Past Due | Total<br>Past Due | Current      | Total<br>Loans | Recorded<br>Investment<br>> 90 Days<br>and<br>Accruing |
|------------------------------|---------------------------------|---------------------------------|------------------------------------|-------------------|--------------|----------------|--|
| Commercial and industrial    | \$ 246                          | \$ 60                           | \$ 30                              | \$ 336            | \$ 192,327   | \$ 192,663     | \$ —   |
| Real estate:                 |                                 |                                 |                                    |                   |              |                |  |
| Construction and development | 77                              | —                               | —                                  | 77                | 200,990      | 201,067        | —  |
| Commercial real estate       | —                               | 38                              | 1,521                              | 1,559             | 391,755      | 393,314        | —  |
| Farmland                     | 2                               | —                               | 6                                  | 8                 | 54,341       | 54,349         | —  |
| 1-4 family residential       | 2,701                           | 838                             | 1,894                              | 5,433             | 360,456      | 365,889        | —  |
| Multi-family residential     | —                               | —                               | 228                                | 228               | 23,007       | 23,235         | —  |
| Consumer                     | 617                             | 201                             | 94                                 | 912               | 50,799       | 51,711         | —  |
| Agricultural                 | 66                              | —                               | 4                                  | 70                | 24,379       | 24,449         | —  |
| Overdrafts                   | —                               | —                               | —                                  | —                 | 698          | 698            | —  |
| Total                        | \$ 3,709                        | \$ 1,137                        | \$ 3,777                           | \$ 8,623          | \$ 1,298,752 | \$ 1,307,375   | \$ —   |
| December 31, 2016            | 30 to 59<br>Days<br>Past<br>Due | 60 to 89<br>Days<br>Past<br>Due | 90 Days<br>and Greater<br>Past Due | Total<br>Past Due | Current      | Total<br>Loans | Recorded<br>Investment<br>> 90 Days<br>and<br>Accruing |
| Commercial and industrial    | \$ 941                          | \$ 105                          | \$ 25                              | \$ 1,071          | \$ 222,926   | \$ 223,997     | \$ —   |
| Real estate:                 |                                 |                                 |                                    |                   |              |                |  |
| Construction and development | 73                              | —                               | 1,825                              | 1,898             | 127,468      | 129,366        | —  |
| Commercial real estate       | 1,629                           | 32                              | 134                                | 1,795             | 365,861      | 367,656        | —  |
| Farmland                     | 100                             | 26                              | 7                                  | 133               | 62,229       | 62,362         | —  |
| 1-4 family residential       | 3,724                           | 803                             | 1,041                              | 5,568             | 357,384      | 362,952        | —  |
| Multi-family residential     | 207                             | 49                              | —                                  | 256               | 25,823       | 26,079         | —  |
| Consumer                     | 613                             | 205                             | 87                                 | 905               | 52,600       | 53,505         | —  |
| Agricultural                 | 59                              | —                               | 15                                 | 74                | 18,827       | 18,901         | —  |
| Overdrafts                   | —                               | —                               | —                                  | —                 | 317          | 317            | —  |
| Total                        | \$ 7,346                        | \$ 1,220                        | \$ 3,134                           | \$ 11,700         | \$ 1,233,435 | \$ 1,245,135   | \$ —   |

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GUARANTY BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

The following table presents information regarding nonaccrual loans as of:

|                              | September 30, December 31, |          |
|------------------------------|----------------------------|----------|
|                              | 2017                       | 2016     |
| Commercial and industrial    | \$ 57                      | \$ 82    |
| Real estate:                 |                            |          |
| Construction and development | —                          | 1,825    |
| Commercial real estate       | 2,113                      | 415      |
| Farmland                     | 162                        | 176      |
| 1-4 family residential       | 2,716                      | 1,699    |
| Multi-family residential     | 228                        | 5        |
| Consumer                     | 164                        | 192      |
| Agricultural                 | 315                        | 15       |
| Total                        | \$ 5,755                   | \$ 4,409 |

## Impaired Loans and Troubled Debt Restructurings

A troubled debt restructuring (“TDR”) is a restructuring in which a bank, for economic or legal reasons related to a borrower’s financial difficulties, grants a concession to the borrower that it would not otherwise consider. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due from the borrower in accordance with original contractual terms of the loan. Loans with insignificant delays or insignificant short falls in the amount of payments expected to be collected are not considered to be impaired. Loans defined as individually impaired, based on applicable accounting guidance, include larger balance nonperforming loans and TDRs.

The outstanding balances of TDRs are shown below:

|                           | September 30, December 31, |        |
|---------------------------|----------------------------|--------|
|                           | 2017                       | 2016   |
| Nonaccrual TDRs           | \$ —                       | \$ 43  |
| Performing TDRs           | 316                        | 462    |
| Total                     | \$ 316                     | \$ 505 |
| Specific reserves on TDRs | \$ 19                      | \$ 4   |

The following tables present loans by class modified as TDRs that occurred during the nine months ended September 30, 2017 and 2016:

|                                      | Number    | Pre-Modification | Post-Modification |
|--------------------------------------|-----------|------------------|-------------------|
| Nine Months Ended September 30, 2017 | of        | Outstanding      | Outstanding       |
|                                      | Contracts | Recorded         | Recorded          |
|                                      |           | Investment       | Investment        |
| Commercial and industrial            | 1         | \$ 34            | \$ 15             |
| 1-4 family residential               | 1         | 11               | 11                |
| Total                                | 2         | \$ 45            | \$ 26             |

There were no TDRs that have subsequently defaulted through September 30, 2017. The TDRs described above increased the allowance for loan losses by \$19 and resulted in no charge-offs during the nine months ended September 30, 2017.

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(Dollars in thousands, except per share data)

| Nine Months Ended September 30, 2016 | Number<br>of<br>Contracts | Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment |
|--------------------------------------|---------------------------|---|--|
| Commercial and industrial            | 1                         | \$ 90   | \$ 90  |
| Commercial real estate               | 1                         | 796   | 796  |
| 1-4 family residential               | 2                         | 189   | 189  |
| Total                                | 4                         | \$ 1,075  | \$ 1,075   |

There were no TDRs that subsequently defaulted in 2016. The TDRs described above did not increase the allowance for loan losses and resulted in no charge-offs during the nine months ended September 30, 2016.

The following table presents information about the Company's impaired loans as of:

| September 30, 2017                  | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Related<br>Allowance | Average<br>Recorded<br>Investment |
|-------------------------------------|--------------------------------|------------------------|----------------------|-----------------------------------|
| With no related allowance recorded: |                                |                        |                      |                                   |
| Commercial and industrial           | \$ 325                         | \$ 325                 | \$ —                 | \$ 381                            |
| Real estate:                        |                                |                        |                      |                                   |
| Construction and development        | —                              | —                      | —                    | 415                               |
| Commercial real estate              | 3,746                          | 3,746                  | —                    | 4,363                             |
| Farmland                            | 120                            | 120                    | —                    | 106                               |
| 1-4 family residential              | 231                            | 231                    | —                    | 1,288                             |
| Multi-family residential            | 228                            | 228                    | —                    | 166                               |
| Consumer                            | —                              | —                      | —                    | 81                                |
| Agricultural                        | 397                            | 397                    | —                    | 380                               |
| Subtotal                            | 5,047                          | 5,047                  | —                    | 7,180                             |
| With allowance recorded:            |                                |                        |                      |                                   |
| Commercial and industrial           | 29                             | 29                     | 19                   | 411                               |
| Real estate:                        |                                |                        |                      |                                   |
| Construction and development        | —                              | —                      | —                    | 10                                |
| Commercial real estate              | 283                            | 283                    | 31                   | 580                               |
| Farmland                            | 156                            | 156                    | 85                   | 122                               |
| 1-4 family residential              | 866                            | 866                    | 145                  | 867                               |
| Multi-family residential            | —                              | —                      | —                    | 26                                |
| Consumer                            | —                              | —                      | —                    | 56                                |
| Agricultural                        | 299                            | 299                    | 240                  | 176                               |
| Subtotal                            | 1,633                          | 1,633                  | 520                  | 2,248                             |
| Total                               | \$ 6,680                       | \$ 6,680               | \$ 520               | \$ 9,428                          |

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

The following table presents information about the Company's impaired loans as of:

| December 31, 2016                   | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Related<br>Allowance | Average<br>Recorded<br>Investment |
|-------------------------------------|--------------------------------|------------------------|----------------------|-----------------------------------|
| With no related allowance recorded: |                                |                        |                      |                                   |
| Commercial and industrial           | \$ 28                          | \$ 28                  | \$ —                 | \$ 809                            |
| Real estate:                        |                                |                        |                      |                                   |
| Construction and development        | 1,825                          | 1,825                  | —                    | 172                               |
| Commercial real estate              | 1,196                          | 1,196                  | —                    | 871                               |
| Farmland                            | 89                             | 89                     | —                    | 109                               |
| 1-4 family residential              | 1,799                          | 1,799                  | —                    | 1,575                             |
| Multi-family residential            | 5                              | 5                      | —                    | 2                                 |
| Consumer                            | 105                            | 105                    | —                    | 89                                |
| Agricultural                        | 15                             | 15                     | —                    | 68                                |
| Subtotal                            | 5,062                          | 5,062                  | —                    | 3,695                             |
| With allowance recorded:            |                                |                        |                      |                                   |
| Commercial and industrial           | 203                            | 203                    | 64                   | 3,153                             |
| Real estate:                        |                                |                        |                      |                                   |
| Farmland                            | 169                            | 169                    | 47                   | 169                               |
| 1-4 family residential              | 789                            | 789                    | 108                  | 639                               |
| Consumer                            | 95                             | 95                     | 34                   | 155                               |
| Agricultural                        | —                              | —                      | —                    | 2                                 |
| Subtotal                            | 1,256                          | 1,256                  | 253                  | 4,118                             |
| Total                               | \$ 6,318                       | \$ 6,318               | \$ 253               | \$ 7,813                          |

During the nine months ended September 30, 2017 and 2016, total interest income and cash-based interest income recognized on impaired loans was minimal.

## NOTE 5 - SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE AND OTHER DEBT

At September 30, 2017 and December 31, 2016, securities sold under agreements to repurchase totaled \$12,920 and \$10,859, respectively.

The Company has a \$25.0 million revolving line of credit, which had an outstanding balance of \$0 at quarter end, bears interest at the prime rate plus 0.50%, with interest payable quarterly, and matures in March 2018.

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## NOTE 6 - SUBORDINATED DEBENTURES

Subordinated debentures are made up of the following as of:

|                        | September 30,<br>2017 | December 31,<br>2016 |
|------------------------|-----------------------|----------------------|
| Trust II Debentures    | \$ 3,093              | \$ 3,093             |
| Trust III Debentures   | 2,062                 | 2,062                |
| DCB Trust I Debentures | 5,155                 | 5,155                |
| Other debentures       | 3,500                 | 9,000                |
|                        | \$ 13,810             | \$ 19,310            |

The Company has three trusts, Guaranty (TX) Capital Trust II (“Trust II”), Guaranty (TX) Capital Trust III (“Trust III”), and DCB Financial Trust I (“DCB Trust I”) (“Trust II”, “Trust III” and together with “DCB Trust I,” the “Trusts”). Upon formation, the Trusts issued pass-through securities (“TruPS”) with a liquidation value of \$1,000 per share to third parties in private placements. Concurrently with the issuance of the TruPS, the Trusts issued common securities to the Company. The Trusts invested the proceeds of the sales of securities to the Company (“Debentures”). The Debentures mature approximately 30 years after the formation date, which may be shortened if certain conditions are met (including the Company having received prior approval of the Federal Reserve and any other required regulatory approvals).

|                                       | Trust II            | Trust III        | DCB Trust I       |
|---------------------------------------|---------------------|------------------|-------------------|
| Formation date                        | October 30,<br>2002 | July 25,<br>2006 | March 29,<br>2007 |
| Capital trust pass-through securities |                     |                  |                   |
| Number of shares                      | 3,000               | 2,000            | 5,000             |
| Original liquidation value            | \$ 3,000            | \$ 2,000         | \$ 5,000          |
| Common securities liquidation value   | 93                  | 62               | 155               |

The securities held by the Trusts qualify as Tier 1 capital for the Company under Federal Reserve Board guidelines. The Federal Reserve’s guidelines restrict core capital elements (including trust preferred securities and qualifying perpetual preferred stock) to 25% of all core capital elements, net of goodwill less any associated deferred tax liability. Because the Company’s aggregate amount of trust preferred securities is less than the limit of 25% of Tier 1 capital, net of goodwill, the full amount is includable in Tier 1 capital at September 30, 2017 and December 31, 2016. Additionally, the terms provide that trust preferred securities would no longer qualify for Tier 1 capital within five years of their maturity, but would be included as Tier 2 capital. However, the trust preferred securities would be amortized out of Tier 2 capital by one-fifth each year and excluded from Tier 2 capital completely during the year prior to maturity of the junior subordinated debentures.

With certain exceptions, the amount of the principal and any accrued and unpaid interest on the Debentures are subordinated in right of payment to the prior payment in full of all senior indebtedness of the Company. Interest on the Debentures is payable quarterly. The interest is deferrable on a cumulative basis for up to five consecutive years following a suspension of dividend payments on all other capital stock. No principal payments are due until maturity for each of the Debentures.

|                 | Trust II<br>Debentures | Trust III<br>Debentures | DCB Trust<br>I<br>Debentures |
|-----------------|------------------------|-------------------------|------------------------------|
| Original amount | \$ 3,093               | \$ 2,062                | \$ 5,155                     |
| Maturity date   | October 30,<br>2032    | October 1,<br>2036      | June 15,<br>2037             |
| Interest due    | Quarterly              | Quarterly               | Quarterly                    |

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In accordance with ASC 810, "Consolidation," the junior subordinated debentures issued by the Company to the subsidiary trusts are shown as liabilities in the consolidated balance sheets and interest expense associated with the junior subordinated debentures is shown in the consolidated statements of earnings.

Trust II Debentures

Interest is payable at a variable rate per annum, reset quarterly, equal to 3 month LIBOR plus 3.35%.

On any interest payment date on or after October 30, 2012 and prior to maturity date, the debentures are redeemable for cash at the option of the Company, on at least 30, but not more than 60 days' notice, in whole or in part, at a redemption price equal to 100% of the principal amount to be redeemed, plus accrued interest to the date of redemption.

Trust III Debentures

Interest was payable at a variable rate per annum, reset quarterly, equal to 3 month LIBOR plus 1.67%.

On any interest payment date on or after October 1, 2016 and prior to maturity date, the debentures are redeemable for cash at the option of the Company, on at least 30, but not more than 60 days' notice, in whole or in part, at a redemption price equal to 100% of the principal amount to be redeemed, plus accrued interest to the date of redemption.

DCB Trust I Debentures

Interest is payable at a variable rate per annum, reset quarterly, equal to 3 month LIBOR plus 1.80%.

On any interest payment date on or after June 15, 2012 and prior to maturity date, the debentures are redeemable for cash at the option of the Company, on at least 30, but not more than 60 days' notice, in whole or in part, at a redemption price equal to 100% of the principal amount to be redeemed, plus accrued interest to the date of redemption.

Other debentures

In July 2015, the Company issued \$4,000 in debentures, of which \$3,000 were issued to directors and other related parties. The \$3,000 of debentures to related parties were repaid in May 2017 and a \$500 par value debenture, which carried a rate of 2.5%, matured and was repaid in July 2017. The remaining \$500 debenture has a rate of 4.00% and a maturity date of January 1, 2019. At the Company's option, and with 30 days advanced notice to the holder, the entire principal amount and all accrued interest may be paid to the holder on or before the due date of any debenture. The redemption price is equal to 100% of the face amount of the debenture redeemed, plus all accrued interest.

In December 2015, the Company issued \$5,000 in debentures, of which \$2,500 were issued to directors and other related parties. In May 2017, \$2,000 of the related party debentures were repaid with a portion of the proceeds of Guaranty's initial public offering. The remaining \$3,000 of debentures were issued at par value of \$500 each with rates ranging from 3.00% to 5.00% and maturity dates from July 1, 2018 to July 1, 2020. At the Company's option, and with 30 days advanced notice to the holder, the entire principal amount and all accrued interest may be paid to the holder on or before the due date of any debenture. The redemption price is equal to 100% of the face amount of the debenture redeemed, plus all accrued interest.

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GUARANTY BANCSHARES, INC.

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## NOTE 7 - STOCK OPTIONS

The Company's 2015 Equity Incentive Plan (the "Plan") which was adopted by the Company and approved by its shareholders in April 2015, amended and restated the Company's 2014 Stock Option Plan. The maximum number of shares of common stock that may be issued pursuant to stock-based awards under the Plan equals 1,000,000 shares, all of which may be subject to incentive stock option treatment. Option awards are generally granted with an exercise price equal to the market price of the Company's common stock at the date of grant. Currently outstanding option awards have vesting periods ranging from 5 to 10 years and have 10-year contractual terms.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. Expected volatilities are based on historical volatilities of the Company's common stock and similar peer group averages. The Company uses historical data to estimate option exercise and post-vesting termination behavior. The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding, which takes in to account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on U.S. Treasury yield curve in effect at the time of the grant.

A summary of activity in the Plan during the nine months ended September 30, 2017 and 2016 follows:

| Nine Months Ended September 30, 2017 | Number of Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Life in Years | Contractual | Aggregate Intrinsic Value |
|--------------------------------------|------------------|---------------------------------|--|-------------|---------------------------|
| Outstanding at beginning of year     | 340,377          | \$ 23.43                        | 7.34                                     |             | \$ 194                    |
| Granted                              | 150,598          | 27.64                           | 9.62                                     |             | 657                       |
| Exercised                            | (7,033 )         | 11.94                           | 4.48                                     |             | 141                       |
| Forfeited                            | (6,000 )         | 23.17                           | 7.13                                     |             | 53                        |
| Balance, September 30, 2017          | 477,942          | \$ 24.93                        | 7.57                                     |             | \$ 3,376                  |
| Exercisable at end of period         | 98,044           | \$ 23.45                        | 6.17                                     |             | \$ 838                    |
| Nine Months Ended September 30, 2016 | Number of Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Life in Years | Contractual | Aggregate Intrinsic Value |
| Outstanding at beginning of year     | 314,391          | \$ 23.28                        | 8.00                                     |             | \$ 225                    |
| Granted                              | 37,500           | 23.44                           | 9.50                                     |             | 21                        |
| Forfeited                            | (19,000 )        | 23.16                           | 8.15                                     |             | 16                        |
| Balance, September 30, 2016          | 332,891          | \$ 23.31                        | 7.45                                     |             | \$ 230                    |
| Exercisable at end of period         | 58,491           | \$ 21.24                        | 6.53                                     |             | \$ 161                    |

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GUARANTY BANCSHARES, INC.

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(Dollars in thousands, except per share data)

A summary of nonvested activity in the Plan during the nine months ended September 30, 2017 and 2016 follows:

| Nine Months Ended September 30, 2017 | Number of Shares | Weighted-Average Exercise Price | Weighted-Average Life in Years | Remaining Contractual | Aggregate Intrinsic Value |
|--------------------------------------|------------------|---------------------------------|--------------------------------|-----------------------|---------------------------|
| Outstanding at beginning of year     | 250,700          | \$ 23.73                        | 7.65                           |                       | \$ 69                     |
| Granted                              | 150,598          | 27.64                           | 9.62                           |                       | 657                       |
| Vested                               | (17,400 )        | 23.13                           | 7.91                           |                       | 154                       |
| Forfeited                            | (4,000 )         | 23.17                           | 7.13                           |                       | 53                        |
| Balance, September 30, 2017          | 379,898          | \$ 25.31                        | 7.93                           |                       | \$ 2,538                  |

| Nine Months Ended September 30, 2016 | Number of Shares | Weighted-Average Exercise Price | Weighted-Average Life in Years | Remaining Contractual | Aggregate Intrinsic Value |
|--------------------------------------|------------------|---------------------------------|--------------------------------|-----------------------|---------------------------|
| Outstanding at beginning of year     | 267,200          | \$ 23.72                        | 8.22                           |                       | \$ 76                     |
| Granted                              | 37,500           | 23.44                           | 9.50                           |                       | 21                        |
| Vested                               | (13,500 )        | 23.00                           | 8.59                           |                       | 14                        |
| Forfeited                            | (16,800 )        | 23.16                           | 8.15                           |                       | 16                        |
| Balance, September 30, 2016          | 274,400          | \$ 23.75                        | 7.65                           |                       | \$ 69                     |

Information related to the Plan is as follows for the nine months ended:

|  | September 30, 2017 |
|--|--------------------|
| Intrinsic value of options exercised           | \$ 141             |
| Cash received from options exercised           | 84                 |
| Tax benefit realized from options exercised    | —                  |
| Weighted average fair value of options granted | 5.40               |

As of September 30, 2017, there was \$1,963 of total unrecognized compensation expense related to unvested stock options granted under the Plan. The expense is expected to be recognized over a weighted-average period of 4.43 years.

The Company granted options under the Plan during the first nine months of 2016 and 2017. Expense of \$247 and \$162 was recorded during the nine months ended September 30, 2017 and 2016, respectively.

## NOTE 8 - EMPLOYEE BENEFITS

## KSOP

The Company maintains an Employee Stock Ownership Plan containing Section 401(k) provisions covering substantially all employees (“KSOP”). The plan provides for a matching contribution of up to 5% of a participant’s qualified compensation starting January 1, 2016. As of December 31, 2016, the plan included a repurchase obligation, or “put option”, which is a right to demand that the sponsor repurchase shares of employer stock distributed to the participant under the terms of the plan, for which there was no public market for such shares, of an established cash price. This put option was terminated upon completion of Guaranty’s initial public offering and listing of its common stock on the NASDAQ Global Select Market in May 2017. Guaranty’s total contributions accrued or paid during the nine months ended September 30, 2017 and 2016 totaled \$739 and \$727, respectively.

Benefits under the KSOP generally are distributed to participants in the form of cash, although participants have the right to receive distributions in the form of shares of common stock.

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As of December 31, 2016, the fair value of shares of common stock, held by the KSOP, was deducted from permanent shareholders' equity in the consolidated balance sheets, and reflected in a line item below liabilities and above shareholders' equity. This presentation was necessary in order to recognize the put option within the KSOP-owned shares, consistent with SEC guidelines, because the Company was not yet publicly traded. The Company used a valuation by an external third party to determine the maximum possible cash obligation related to those securities. Increases or decreases in the value of the cash obligation were included in a separate line item in the statements of changes in shareholders' equity. The fair value of allocated and unallocated shares subject to the repurchase obligation totaled \$31,661 as of December 31, 2016.

As of September 30, 2017 and December 31, 2016, the number of shares held by the KSOP were 1,314,277 and 1,319,225, respectively. There were no unallocated shares to plan participants as of September 30, 2017 and there were 50,000 shares unallocated to plan participants as of December 31, 2016. During the nine months ended September 30, 2017 and 2016, the Company did not repurchase any shares from KSOP participants that received distributions of shares from the KSOP which were subject to the put option that applied to the KSOP shares before we were publicly traded. All shares held by the KSOP were treated as outstanding at each of the respective period ends.

**Executive Incentive Retirement Plan**

The Company established a non-qualified, non-contributory executive incentive retirement plan covering a selected group of key personnel to provide benefits equal to amounts computed under an "award criteria" at various targeted salary levels as adjusted for annual earnings performance of the Company. The plan is non-funded.

In connection with the Executive Incentive Retirement Plan, the Company has purchased life insurance policies on the respective officers. The cash surrender value of life insurance policies held by the Company totaled \$18,376 and \$17,804 as of September 30, 2017 and December 31, 2016, respectively.

Expense related to these plans totaled \$381 and \$329 for the nine months ended September 30, 2017 and 2016, respectively, and is included in employee compensation and benefits on the Company's consolidated statements of earnings. The recorded liability totaled approximately \$2,361 and \$2,002 as of September 30, 2017 and December 31, 2016, respectively and is included in accrued interest and other liabilities on the Company's consolidated balance sheets.

**Bonus Plan**

The Company has a bonus plan that rewards officers and employees based on performance of individual business units of the Company. Earnings and growth performance goals for each business unit and for the Company as a whole are established at the beginning of the calendar year and approved annually by Guaranty's board of directors. The Bonus Plan provides for a predetermined bonus amount to be contributed to the employee bonus pool based on (i) earnings target and growth for individual business units and (ii) achieving certain pre-tax return on average equity and pre-tax return on average asset levels for the Company as a whole. These bonus amounts are established annually by Guaranty's board of directors. The bonus expense under this plan for the nine months ended September 30, 2017 and 2016 totaled \$1,718 and \$1,451, respectively and is included in employee compensation and benefits on the consolidated statements of earnings.

**NOTE 9 - INCOME TAXES**

Income tax expenses were as follows for:

|                                   | Nine Months<br>Ended September<br>30, |         |
|-----------------------------------|---------------------------------------|---------|
|                                   | 2017                                  | 2016    |
| Income tax expense for the period | \$4,644                               | \$3,290 |
| Effective tax rate                | 28.54 %                               | 27.79 % |

The effective tax rates differ from the statutory federal tax rate of 35% largely due to tax exempt interest income earned on certain investment securities and loans and the nontaxable earnings on bank owned life insurance.

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## NOTE 10 - DERIVATIVE FINANCIAL INSTRUMENTS

The Company utilizes certain derivative financial instruments. Stand-alone derivative financial instruments such as interest rate swaps, are used to economically hedge interest rate risk related to the Company's liabilities. These derivative instruments involve both credit and market risk. The notional amounts are amounts on which calculations, payments, and the value of the derivative are based. Notional amounts do not represent direct credit exposures. Direct credit exposure is limited to the net difference between the calculated amounts to be received and paid, if any. Such difference, which represents the fair value of the derivative instruments, is reflected on the Company's consolidated balance sheet in other liabilities.

The Company is exposed to credit related losses in the event of nonperformance by the counterparties to those agreements. The Company controls the credit risk of its financial contracts through credit approvals, limits and monitoring procedures, and does not expect any counterparties to fail to perform their respective obligations.

The Company entered into interest rate swaps to receive payments at a fixed rate in exchange for paying a floating rate on the debentures discussed in Note 6. Management believes that entering into the interest rate swaps exposed the Company to variability in their fair value due to changes in the level of interest rates. It is the Company's objective to hedge the change in fair value of floating rate debentures at coverage levels that are appropriate, given anticipated or existing interest rate levels and other market considerations, as well as the relationship of change in this liability to other liabilities of the Company. To meet this objective, the Company utilizes interest rate swaps as an asset/liability management strategy to hedge the change in value of the cash flows due to changes in expected interest rate assumptions.

Interest rate swaps with notional amounts totaling \$5,000 as of September 30, 2017 and December 31, 2016, were designated as cash flow hedges of the debentures and were determined to be fully effective during all periods presented. As such, no amount of ineffectiveness has been included in net income.

Therefore, the aggregate fair value of the swaps is recorded in accrued interest and other liabilities within the Company's consolidated balance sheets with changes in fair value recorded in other comprehensive income. The amount included in accumulated other comprehensive income would be reclassified to current earnings should the hedges no longer be considered effective. The Company expects the hedges to remain fully effective during the remaining terms of the swaps.

The information pertaining to outstanding interest rate swap agreements used to hedge floating rate debentures was as follows as of:

September 30,  
2017:

| Notional<br>Amount | Pay<br>Rate | Receive<br>Rate          | Effective<br>Date | Maturity<br>in Years | Unrealized<br>Losses |
|--------------------|-------------|--------------------------|-------------------|----------------------|----------------------|
| \$2,000            | 5.979%      | 3 month LIBOR plus 1.67% | October 1, 2016   | 8.51                 | \$ 340               |
| \$3,000            | 7.505%      | 3 month LIBOR plus 3.35% | October 30, 2012  | 5.08                 | \$ 326               |

December 31,  
2016:

| Notional | Pay | Receive | Effective | Maturity | Unrealized |
|----------|-----|---------|-----------|----------|------------|
|----------|-----|---------|-----------|----------|------------|

| Amount  | Rate   | Rate                     | Date             | in Years | Losses |
|---------|--------|--------------------------|------------------|----------|--------|
| \$2,000 | 5.979% | 3 month LIBOR plus 1.67% | October 1, 2016  | 9.25     | \$ 342 |
| \$3,000 | 7.505% | 3 month LIBOR plus 3.35% | October 30, 2012 | 5.83     | \$ 353 |

Interest expense recorded on these swap transactions totaled \$559 and \$656 during the nine months ended September 30, 2017 and 2016, respectively, and is reported as a component of interest expense on the debentures. At September 30, 2017, the Company expected none of the unrealized loss to be reclassified as a reduction of interest expense during the remainder of 2017.

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NOTE 11 - COMMITMENTS AND CONTINGENCIES

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. These transactions are referred to as “off-balance sheet commitments.” The Company enters into these transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and letters of credit, which involve elements of credit risk in excess of the amounts recognized in the consolidated balance sheets. The Company minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures.

The Company enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Customers use credit commitments to ensure that funds will be available for working capital purposes, for capital expenditures and to ensure access to funds at specified terms and conditions. Substantially all of the Company’s commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of the allowance for credit losses.

Letters of credit are written conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The Company’s policies generally require that letters of credit arrangements contain security and debt covenants similar to those contained in loan agreements. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount shown in the table below. If the commitment were funded, the Company would be entitled to seek recovery from the customer. As of September 30, 2017 and December 31, 2016, no amounts have been recorded as liabilities for the Bank’s potential obligations under these guarantees.

Commitments and letters of credit outstanding were as follows as of:

|                              | Contract or Notional<br>Amount |                      |
|------------------------------|--------------------------------|----------------------|
|                              | September 30,<br>2017          | December 31,<br>2016 |
| Commitments to extend credit | \$339,872                      | \$ 297,607           |
| Letters of credit            | 9,334                          | 8,879                |

Litigation

The Company is involved in certain claims and lawsuits occurring in the normal course of business. Management, after consultation with legal counsel, does not believe that the outcome of these actions, if determined adversely, would have a material impact on the consolidated financial statements of the Company.

FHLB Letters of Credit

At September 30, 2017, the Company had letters of credit of \$52,000 pledged to secure public deposits, repurchase agreements, and for other purposes required or permitted by law.

NOTE 12 - REGULATORY MATTERS



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

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A comparison of the Company's and Bank's actual capital amounts and ratios to required capital amounts and ratios are presented in the following tables as of:

|   | Actual             |        | Minimum Required For Capital Adequacy Purposes |       | To Be Well Capitalized Under Prompt Corrective Action Provisions |        |
|---|--------------------|--------|--|-------|--|--------|
|   | Amount             | Ratio  | Amount   | Ratio | Amount   | Ratio  |
|   | September 30, 2017 |        |  |       |  |        |
| Total capital to risk-weighted assets:                |                    |        |  |       |  |        |
| Consolidated  | \$213,905          | 14.62% | \$117,065                                      | 8.00% |  | n/a    |
| Bank  | 202,722            | 13.85% | 117,078  | 8.00% | \$146,348  | 10.00% |
| Tier 1 capital to risk-weighted assets:               |                    |        |  |       |  |        |
| Consolidated  | 201,377            | 13.76% | 87,799   | 6.00% |  | n/a    |
| Bank  | 190,194            | 13.00% | 87,809   | 6.00% | 117,078  | 8.00%  |
| Tier 1 capital to average assets:                     |                    |        |  |       |  |        |
| Consolidated  | 201,377            | 10.68% | 75,457   | 4.00% |  | n/a    |
| Bank  | 190,194            | 10.08% | 75,465   | 4.00% | 94,331   | 5.00%  |
| Common equity tier 1 capital to risk-weighted assets: |                    |        |  |       |  |        |
| Consolidated  | 191,067            | 13.06% | 65,849   | 4.50% |  | n/a    |
| Bank  | 190,195            | 13.11% | 65,307   | 4.50% | 94,333   | 6.50%  |
| December 31, 2016                                     |                    |        |  |       |  |        |
| Total capital to risk-weighted assets:                |                    |        |  |       |  |        |
| Consolidated  | \$149,468          | 10.86% | \$110,083                                      | 8.00% |  | n/a    |
| Bank  | 173,528            | 12.63% | 109,947  | 8.00% | \$137,434  | 10.00% |
| Tier 1 capital to risk-weighted assets:               |                    |        |  |       |  |        |
| Consolidated  | 137,984            | 10.03% | 82,562   | 6.00% |  | n/a    |
| Bank  | 162,044            | 11.79% | 82,460   | 6.00% | 109,947  | 8.00%  |
| Tier 1 capital to average assets:                     |                    |        |  |       |  |        |
| Consolidated  | 137,984            | 7.71%  | 71,560   | 4.00% |  | n/a    |
| Bank  | 162,044            | 9.06%  | 71,505   | 4.00% | 89,381   | 5.00%  |
| Common equity tier 1 capital to risk-weighted assets: |                    |        |  |       |  |        |
| Consolidated  | 127,674            | 9.28%  | 61,922   | 4.50% |  | n/a    |
| Bank  | 162,044            | 11.79% | 61,845   | 4.50% | 89,332   | 6.50%  |

In July 2013, the Federal Reserve published final rules for the adoption of the Basel III regulatory capital framework (the "Basel III Capital Rules"). The Basel III Capital Rules, among other things, (1) introduce a new capital measure called "Common Equity Tier 1" ("CET1"), (2) specify that Tier 1 capital consist of Common Equity Tier 1 and "Additional

Tier 1 Capital” instruments meeting specified requirements, (3) define Common Equity Tier 1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to Common Equity Tier 1 and not to the other components of capital and (4) expand the scope of the deductions/adjustments as compared to existing regulations. The Basel III Capital Rules became effective for the Company on January 1, 2015, with certain transition provisions to be fully phased in by January 1, 2019.

Starting in January 2016, the implementation of the capital conservation buffer became effective for the Company starting at the 0.625% level and increases 0.625% each year thereafter, until it reaches 2.5% on January 1, 2019. The capital conservation buffer is designed to absorb losses during periods of economic stress and effectively increases

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the minimum required risk-weighted capital ratios. Failure to meet the full amount of the buffer will result in restrictions on the Company's ability to make capital distributions, including dividend payments and stock repurchases, and to pay discretionary bonuses to executive officers.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios (set forth in the table above) of total, CETI and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of September 30, 2017 and December 31, 2016 that the Company met all capital adequacy requirements to which it was subject.

As of September 30, 2017 and December 31, 2016, the Bank's capital ratios exceeded those levels necessary to be categorized as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized", the Bank must maintain minimum total risk-based, CETI, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table above. There are no conditions or events since September 30, 2017 that management believes have changed the Bank's capital category under the regulatory framework for prompt corrective action.

The Federal Reserve's guidelines regarding the capital treatment of trust preferred securities limits restricted core capital elements (including trust preferred securities and qualifying perpetual preferred stock) to 25% of all core capital elements, net of goodwill less any associated deferred tax liability. Because the Company's aggregate amount of trust preferred securities is less than the limit of 25% of Tier 1 capital, net of goodwill, the rules permit the inclusion of \$10,310 of trust preferred securities in Tier 1 capital at September 30, 2017 and December 31, 2016. Additionally, the rules provide that trust preferred securities would no longer qualify for Tier 1 capital within five years of their maturity, but would be included as Tier 2 capital. However, the trust preferred securities would be amortized out of Tier 2 capital by one-fifth each year and excluded from Tier 2 capital completely during the year prior to maturity of the subordinated debentures.

Dividends paid by Guaranty are mainly provided by dividends from its subsidiaries. However, certain regulatory restrictions exist regarding the ability of its bank subsidiary to transfer funds to Guaranty in the form of cash dividends, loans or advances. The amount of dividends that a subsidiary bank organized as a national banking association, such as the Bank, may declare in a calendar year is the subsidiary bank's net profits for that year combined with its retained net profits for the preceding two years.

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NOTE 13 - FAIR VALUE

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

Level 1 - Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 - Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 - Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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

**Marketable Securities:** The fair values for marketable securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

**Loans Held For Sale:** Loans held for sale are carried at the lower of cost or fair value, which is evaluated on a pool-level basis. The fair value of loans held for sale is determined using quoted prices for similar assets, adjusted for specific attributes of that loan or other observable market data, such as outstanding commitments from third party investors (Level 2).

**Derivative Instruments:** The fair values of derivatives are based on valuation models using observable market data as of the measurement date (Level 2).

**Impaired Loans:** The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on the present value of estimated future cash flows using the loan's existing rate or, if repayment is expected solely from the collateral, the fair value of collateral, less costs to sell. The fair value of real estate collateral is determined using recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant (Level 3). Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business (Level 3). Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

**Other Real Estate Owned:** Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of

cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals which are updated no less frequently than annually. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Real estate owned properties are evaluated on a quarterly basis for additional impairment and adjusted accordingly (Level 3).

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The following tables summarize quantitative disclosures about the fair value measurements for each category of financial assets (liabilities) carried at fair value:

| As of September 30, 2017                                 | Fair Value | Quoted<br>Prices in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Other<br>Unobservable<br>Inputs<br>(Level 3) |
|--|------------|---|---|---|
| Assets (liabilities) at fair value on a recurring basis: |            |   |   |   |
| Available for sale securities                            |            |   |   |   |
| Mortgage-backed securities                               | \$90,958   | \$  | —\$ 90,958  | \$ —  |
| Collateralized mortgage obligations                      | 120,691    | —   | 120,691   | —   |
| Municipal securities                                     | 7,464      | —   | 7,464   | —   |
| Corporate bonds  | 19,020     | —   | 19,020  | —   |
| Derivative instruments                                   | (666 )     | —   | (666 )  | —   |
| Assets at fair value on a nonrecurring basis:            |            |   |   |   |
| Impaired loans   | 6,160      | —   | —   | 6,160   |
| Other real estate owned                                  | 1,929      | —   | —   | 1,929   |
| As of December 31, 2016                                  |            |   |   |   |
| Assets (liabilities) at fair value on a recurring basis: |            |   |   |   |
| Available for sale securities                            |            |   |   |   |
| Mortgage-backed securities                               | \$59,690   | \$  | —\$ 59,690  | \$ —  |
| Collateralized mortgage obligations                      | 65,133     | —   | 65,133  | —   |
| Municipal securities                                     | 7,219      | —   | 7,219   | —   |
| Corporate bonds  | 24,883     | —   | 24,883  | —   |
| U.S. treasury securities                                 | —          | —   | —   | —   |
| Derivative instruments                                   | (695 )     | —   | (695 )  | —   |
| Assets at fair value on a nonrecurring basis:            |            |   |   |   |
| Impaired loans   | 6,065      | —   | —   | 6,065   |
| Other real estate owned                                  | 1,692      | —   | —   | 1,692   |

There were no transfers between Level 2 and Level 3 during the nine months ended September 30, 2017 or for the year ended December 31, 2016.

Nonfinancial Assets and Nonfinancial Liabilities

Nonfinancial assets measured at fair value on a nonrecurring basis during the nine months ended September 30, 2017 and 2016 include certain foreclosed assets which, upon initial recognition, were remeasured and reported at fair value through a charge-off to the allowance for loan losses and certain foreclosed assets which, subsequent to their initial recognition, were remeasured at fair value through a write-down included in current earnings. The fair value of a foreclosed asset is estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria.

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The following table presents foreclosed assets that were remeasured and recorded at fair value as of:

|  | September 30,<br>2017 | December 31,<br>2016 | September 30,<br>2016 |
|--|-----------------------|----------------------|-----------------------|
| Foreclosed assets remeasured at initial recognition:                         |                       |                      |                       |
| Carrying value of foreclosed assets prior to remeasurement                   | \$ 544                | \$ 78                | \$ 67                 |
| Charge-offs recognized in the allowance for loan losses                      | (175 )                | (11 )                | (11 )                 |
| Fair value of foreclosed assets remeasured at initial recognition            | \$ 369                | \$ 67                | \$ 56                 |
| Foreclosed assets remeasured subsequent to initial recognition:              |                       |                      |                       |
| Carrying value of foreclosed assets prior to remeasurement                   | \$ —                  | \$ 170               | \$ 180                |
| Write-downs included in collection and other real estate owned expense       | —                     | (69 )                | (79 )                 |
| Fair value of foreclosed assets remeasured subsequent to initial recognition | \$ —                  | \$ 101               | \$ 101                |

The following tables present quantitative information about nonrecurring Level 3 fair value measurements as of:

|                         | Fair Value | Valuation<br>Technique(s)                            | Unobservable Input(s)  | Range (Weighted<br>Average)     |
|-------------------------|------------|--|--|---------------------------------|
| September 30,<br>2017   |            |  |  |                                 |
| Impaired loans          | \$ 6,160   | Fair value of collateral - sales comparison approach | Selling costs or other normal adjustments: Real estate Equipment | 10%-20% (16%)<br>10%-20% (5.3%) |
| Other real estate owned | \$ 1,929   | Appraisal value of collateral                        | Selling costs or other normal adjustments                        | 10%-20% (16%)                   |
|                         | Fair Value | Valuation<br>Technique(s)                            | Unobservable Input(s)  | Range (Weighted<br>Average)     |
| December 31,<br>2016    |            |  |  |                                 |
| Impaired loans          | \$ 6,065   | Fair value of collateral - sales comparison approach | Selling costs or other normal adjustments: Real estate Equipment | 10%-20% (16%)<br>40%-50% (42%)  |
| Other real estate owned | \$ 1,692   | Appraisal value of collateral                        | Selling costs or other normal adjustments                        | 10%-20% (16%)                   |

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The carrying amounts and estimated fair values of financial instruments not previously discussed in this note, as of September 30, 2017 and December 31, 2016, are as follows:

|  | Fair value measurements as of<br>September 30, 2017 using: |                   |                   |                   |                     |
|--|--|-------------------|-------------------|-------------------|---------------------|
|  | Carrying<br>Amount   | Level 1<br>Inputs | Level 2<br>Inputs | Level 3<br>Inputs | Total<br>Fair Value |
| Financial assets:  |  |                   |                   |                   |                     |
| Cash, due from banks, federal funds sold and interest-bearing deposits | \$95,061   | \$67,986          | \$27,075          | \$                | —\$95,061           |
| Marketable securities held to maturity                                 | 179,081  | —                 | 181,151           | —                 | 181,151             |
| Loans, net   | 1,294,847  | —                 | —                 | 1,293,992         | 1,293,992           |
| Accrued interest receivable  | 6,440  | —                 | 6,440             | —                 | 6,440               |
| Nonmarketable equity securities  | 9,379  | —                 | 9,379             | —                 | 9,379               |
| Cash surrender value of life insurance                                 | 18,376   | —                 | 18,376            | —                 | 18,376              |
| Financial liabilities:   |  |                   |                   |                   |                     |
| Deposits   | \$1,617,302  | \$1,305,206       | \$305,084         | \$                | —\$1,610,290        |
| Securities sold under repurchase agreements                            | 12,920   | —                 | 12,920            | —                 | 12,920              |
| Accrued interest payable   | 883  | —                 | 883               | —                 | 883                 |
| Federal Home Loan Bank advances  | 65,157   | —                 | 64,856            | —                 | 64,856              |
| Subordinated debentures  | 13,810   | —                 | 11,445            | —                 | 11,445              |
|  | Fair value measurements as of<br>December 31, 2016 using:  |                   |                   |                   |                     |
|  | Carrying<br>Amount   | Level 1<br>Inputs | Level 2<br>Inputs | Level 3<br>Inputs | Total<br>Fair Value |
| Financial assets:  |  |                   |                   |                   |                     |
| Cash, due from banks, federal funds sold and interest-bearing deposits | \$127,543  | \$100,205         | \$27,338          | \$                | —\$127,543          |
| Marketable securities held to maturity                                 | 189,371  | —                 | 186,155           | —                 | 186,155             |
| Loans, net   | 1,233,651  | —                 | —                 | 1,235,306         | 1,235,306           |
| Accrued interest receivable  | 7,419  | —                 | 7,419             | —                 | 7,419               |
| Nonmarketable equity securities  | 10,500   | —                 | 10,500            | —                 | 10,500              |
| Cash surrender value of life insurance                                 | 17,804   | —                 | 17,804            | —                 | 17,804              |
| Financial liabilities:   |  |                   |                   |                   |                     |
| Deposits   | \$1,576,791  | \$1,234,875       | \$342,615         | \$                | —\$1,577,490        |
| Securities sold under repurchase agreements                            | 10,859   | —                 | 10,859            | —                 | 10,859              |
| Accrued interest payable   | 889  | —                 | 889               | —                 | 889                 |
| Other debt   | 18,286   | —                 | 18,286            | —                 | 18,286              |
| Federal Home Loan Bank advances  | 55,170   | —                 | 55,160            | —                 | 55,160              |
| Subordinated debentures  | 19,310   | —                 | 16,809            | —                 | 16,809              |

The methods and assumptions, not previously presented, used to estimate fair values are described as follows:

Cash and Cash Equivalents

The carrying amounts of cash and short-term instruments approximate fair values (Level 1).

(Continued)

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GUARANTY BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

Loans, net

The fair value of fixed-rate loans and variable-rate loans that reprice on an infrequent basis is estimated by discounting future cash flows using the current interest rates at which similar loans with similar terms would be made to borrowers of similar credit quality (Level 3).

Cash Surrender Value of Life Insurance

The carrying amounts of bank-owned life insurance approximate their fair value.

Nonmarketable Equity Securities

It is not practical to determine the fair value of Independent Bankers Financial Corporation, Federal Home Loan Bank, Federal Reserve Bank and other stock due to restrictions placed on its transferability.

Deposits and Securities Sold Under Repurchase Agreements

The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) (Level 1). The fair values of deposit liabilities with defined maturities are estimated by discounting future cash flows using interest rates currently offered for deposits of similar remaining maturities (Level 2).

Other Borrowings

The fair value of borrowings, consisting of lines of credit, Federal Home Loan Bank advances and Subordinated debentures is estimated by discounting future cash flows using currently available rates for similar financing (Level 2).

Accrued Interest Receivable/Payable

The carrying amounts of accrued interest approximate their fair values (Level 2).

Off-balance Sheet Instruments

Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of commitments is not material.

NOTE 14 - EARNINGS PER SHARE

Basic earnings per share is computed by dividing net earnings available to common shareholders by the weighted-average common shares outstanding for the period. Diluted earnings per share reflects the maximum potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock and would then share in the net earnings of the Company. Dilutive share equivalents include stock-based awards issued to employees.

Stock options granted by the Company are treated as potential shares in computing earnings per share. Diluted shares outstanding include the dilutive effect of in-the-money awards which is calculated based on the average share price for each fiscal period using the treasury stock method. Under the treasury stock method, the amount that the employee must pay for exercising stock options, the amount of compensation cost for future service that the Company has not yet recognized, and the amount of tax impact that would be recorded in additional paid-in capital when the award

becomes deductible are assumed to be used to repurchase shares.

(Continued)

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GUARANTY BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

The computations of basic and diluted earnings per share for the Company were as follows for the:

|   | Three Months<br>Ended<br>September 30,<br>2017 |            | 2016       |           | Nine Months<br>Ended<br>September 30,<br>2017 |  | 2016 |  |
|---|--|------------|------------|-----------|---|--|------|--|
| Numerator:  |  |            |            |           |   |  |      |  |
| Net earnings (basic)                              | \$4,139  | \$ 3,370   | \$11,631   | \$ 8,547  |   |  |      |  |
| Net earnings (diluted)                            | \$4,139  | \$ 3,370   | \$11,631   | \$ 8,547  |   |  |      |  |
| Denominator:                                      |  |            |            |           |   |  |      |  |
| Weighted-average shares outstanding (basic)       | 11,058,985                                     | 10,554,476 | 9,951,767  | 8,991,671 |   |  |      |  |
| Effect of dilutive securities:                    |  |            |            |           |   |  |      |  |
| Common stock equivalent shares from stock options | 105,473  | 39,581     | 75,505     | 9,581     |   |  |      |  |
| Weighted-average shares outstanding (diluted)     | 11,164,458                                     | 10,650,057 | 10,027,272 | 9,001,252 |   |  |      |  |
| Net earnings per share                            |  |            |            |           |   |  |      |  |
| Basic   | \$0.37   | \$ 0.38    | \$1.17     | \$ 0.95   |   |  |      |  |
| Diluted   | \$0.37   | \$ 0.38    | \$1.16     | \$ 0.95   |   |  |      |  |

(Continued)

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

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 notes thereto appearing in Item 1 of Part I of this Quarterly Report on Form 10-Q (this "Report") as well as with our consolidated financial statements and notes thereto appearing in our Prospectus, filed with the SEC on May 9, 2017 pursuant to Rule 424(b) of the Securities Act of 1933, as amended (the "Securities Act"), relating to our initial public offering (the "IPO Prospectus"). Unless the context indicates otherwise, references in this Report to "we," "our," "us," and the "Company" refer to Guaranty Bancshares, Inc., a Texas Corporation, and its consolidated subsidiaries. References in this Report to "Guaranty Bank & Trust" and the "Bank" refer to Guaranty Bank & Trust, N.A., a national banking association and our wholly owned consolidated subsidiary.

This discussion and analysis contains forward-looking statements that are subject to certain risks and uncertainties and are based on certain assumptions that we believe are reasonable but may prove to be inaccurate. Certain risks, uncertainties and other factors, including those set forth under "Forward-Looking Statements" and "Risk Factors" in our IPO Prospectus, may cause actual results to differ materially from those projected results discussed in the forward-looking statements appearing in this discussion and analysis. We assume no obligation to update any of these forward-looking statements. For additional information concerning forward-looking statements, please read "-Special Cautionary Notice Regarding Forward-Looking Statements" below.

### General

We were incorporated in 1990 to serve as the holding company for Guaranty Bank & Trust. Since our founding, we have built a reputation based on financial stability and community leadership. In May 2017, we consummated an initial public offering of our common stock, which is traded on the NASDAQ Global Select Market under the symbol "GNTY."

We currently operate 26 banking locations in the Dallas/Fort Worth, East Texas and Central Texas regions of the state. Our growth has been consistent and primarily organic. Our principal executive office is located at 201 South Jefferson Street, Mount Pleasant, Texas 75455, and our telephone number is (903) 572-9881. Our website address is [www.gnty.com](http://www.gnty.com). Information contained on our website does not constitute a part of this Report and is not incorporated by reference into this filing or any other report.

As a bank holding company that operates through one segment, we generate most of our revenue from interest on loans and investments, customer service and loan fees, fees related to the sale of mortgage loans, and trust and wealth management services. We incur interest expense on deposits and other borrowed funds, as well as noninterest expense, such as salaries and employee benefits and occupancy expenses. We analyze our ability to maximize income generated from interest earning assets and control the interest expenses of our liabilities, measured as net interest income, through our net interest margin and net interest spread. Net interest income is 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, which are used to fund those assets. Net interest margin is a ratio calculated as net interest income divided by average interest-earning assets. Net interest spread is the difference between rates earned on interest-earning assets and rates paid on interest-bearing liabilities.

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 assets, interest-bearing and noninterest-bearing liabilities and shareholders' equity, 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.

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### Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with GAAP and with general practices within the financial services industry. Application of these principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under current circumstances. These assumptions form the basis for our judgments about the carrying values of assets and liabilities that are not readily available from independent, objective sources. We evaluate our estimates on an ongoing basis. Use of alternative assumptions may have resulted in significantly different estimates. Actual results may differ from these estimates.

We have identified the following accounting policies and estimates that, due to the difficult, subjective or complex judgments and assumptions inherent in those policies and estimates, and the potential sensitivity of our consolidated financial statements to those judgments and assumptions, is critical to an understanding of our financial condition and results of operations. We believe that the judgments, estimates and assumptions used in the preparation of our financial statements are appropriate.

#### Loans and Allowance for Loan Losses

Loans are stated at the amount of unpaid principal, reduced by unearned income and an allowance for loan losses.

Interest on loans is recognized using the simple-interest method on the daily balances of the principal amounts outstanding. Fees associated with the origination of loans and certain direct loan origination costs are netted and the net amount is deferred and recognized over the life of the loan as an adjustment of yield.

The accrual of interest on loans is discontinued when there is a clear indication that the borrower's cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. A loan may continue to accrue interest, even if it is more than 90 days past due, if the loan is both well collateralized and it is in the process of collection. When a loan is placed on nonaccrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining book balance of the asset is deemed to be collectible. If collectability is questionable, then cash payments are applied to principal. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured in accordance with the terms of the loan agreement.

The allowance for loan losses is an estimated amount management believes is adequate to absorb inherent losses on existing loans that may be uncollectible based upon review and evaluation of our loan portfolio. Management's periodic evaluation of the allowance is based on general economic conditions, the financial condition of borrowers, the value and liquidity of collateral, delinquency, prior loan loss experience and the results of periodic reviews of the portfolio.

The allowance for loan losses is comprised of two components. The first component, the general reserve, is determined in accordance with current authoritative accounting guidance that considers historical loss rates for the last five years adjusted for qualitative factors based upon general economic conditions and other qualitative risk factors both internal and external to us. Such qualitative factors include current local economic conditions and trends including unemployment, changes in lending staff, policies and procedures, changes in credit concentrations, changes in the trends and severity of problem loans and changes in trends in volume and terms of loans. These qualitative factors serve to compensate for additional areas of uncertainty inherent in the portfolio that are not reflected in our historic loss factors. For purposes of determining the general reserve, the loan portfolio, less cash secured loans, government guaranteed loans and impaired loans, is multiplied by our adjusted historical loss rate. The second component of the allowance for loan losses, the specific reserve, is determined in accordance with current authoritative accounting guidance based on probable and incurred losses on specific classified loans.

The allowance for loan losses is increased by charges to income and decreased by charge-offs (net of recoveries).

In general, the loans in our portfolio have low historical credit losses. The credit quality of loans in our portfolios is impacted by delinquency status and debt service coverage generated by our borrowers' businesses and fluctuations in the value of real estate collateral. Management considers delinquency status to be the most meaningful indicator of the credit quality of one-to-four single family residential, home equity loans and lines of credit and other consumer loans. In general, loans do not begin to show signs of credit deterioration or default until they have been outstanding

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for some period of time, a process we refer to as “seasoning.” As a result, a portfolio of older loans will usually behave more predictably than a portfolio of newer loans. We consider the majority of our loans to be “seasoned” and that the credit quality and current level of delinquencies and defaults represents the level of reserve needed in the allowance for loan losses. If delinquencies and defaults were to increase, we may be required to increase our provision for loan losses, which would adversely affect our results of operations and financial condition.

Delinquency statistics are updated at least monthly. Internal risk ratings are considered the most meaningful indicator of credit quality for new commercial and industrial, construction, and commercial real estate loans. Internal risk ratings are a key factor in identifying loans that are individually evaluated for impairment and impact management’s estimates of loss factors used in determining the amount of the allowance for loan losses. Internal risk ratings are updated on a continuous basis.

Loans are considered impaired when, based on current information and events, it is probable we will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. If a loan is impaired, a specific valuation allowance is allocated, if necessary. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Our policy requires measurement of the allowance for an impaired collateral dependent loan based on the fair value of the collateral. Other loan impairments are measured based on the present value of expected future cash flows or the loan’s observable market price. As of September 30, 2017 and December 31, 2016, all significant impaired loans have been determined to be collateral dependent and the allowance for loss has been measured utilizing the estimated fair value of the collateral.

From time to time, we modify our loan agreement with a borrower. A modified loan is considered a troubled debt restructuring when two conditions are met: (i) the borrower is experiencing financial difficulty and (ii) concessions are made by us that would not otherwise be considered for a borrower with similar credit risk characteristics.

Modifications to loan terms may include a lower interest rate, a reduction of principal, or a longer term to maturity.

We review each troubled debt restructured loan and determine on a case by case basis if the loan is subject to impairment and the need for a specific allowance for loan loss allocation. An allowance for loan loss allocation is based on either the present value of estimated future cash flows or the estimated fair value of the underlying collateral.

We have certain lending policies and procedures in place that are designed to maximize loan income with an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis and makes changes as appropriate. Management receives frequent reports related to loan originations, quality,

concentrations, delinquencies, non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions, both by type of loan and geography.

Commercial and industrial loans are underwritten after evaluating and understanding the borrower’s ability to operate profitably and effectively. Underwriting standards are designed to determine whether the borrower possesses sound business ethics and practices and to evaluate current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and, secondarily, on the underlying collateral provided by the borrower. Most commercial and industrial loans are secured by the assets being financed or other business assets, such as accounts receivable or inventory, and include personal guarantees.

Real estate loans are also subject to underwriting standards and processes similar to commercial and industrial loans.

These loans are underwritten primarily based on projected cash flows and, secondarily, as loans secured by real estate collateral. The repayment of real estate loans is generally largely dependent on the successful operation of the property securing the loans or the business conducted on the property securing the loan. Real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing our real estate portfolio are generally diverse in terms of type and geographic location throughout the State of Texas. This diversity helps us reduce the exposure to adverse economic events that affect any single market or industry.

We utilize methodical credit standards and analysis to supplement our policies and procedures in underwriting consumer loans. Our loan policy addresses types of consumer loans that may be originated as well as the underlying

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collateral, if secured, which must be perfected. The relatively small individual dollar amounts of consumer loans that are spread over numerous individual borrowers also minimizes risk.

#### Marketable Securities

Securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income. Management determines the appropriate classification of securities at the time of purchase. Interest income includes amortization and accretion of purchase premiums and discounts. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment (“OTTI”) on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: (1) OTTI related to credit loss, which must be recognized in the income statement and (2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

#### Fair Values of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions. 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. The fair value estimates of existing on and off-balance sheet financial instruments do not include the value of anticipated future business or the value of assets and liabilities not considered financial instruments.

#### Emerging Growth Company

The 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. However, we have “opted out” of this provision. As a result, we will comply with new or revised accounting standards to the same extent that compliance is required for non-emerging growth companies. Our decision to opt out of the extended transition period under the JOBS Act is irrevocable.

#### Discussion and Analysis of Results of Operations for the Nine Months Ended September 30, 2017 and 2016 Results of Operations

The following discussion and analysis of our results of operations compares our results of operations for the nine months ended September 30, 2017 with the nine months ended September 30, 2016. The results of operations for the nine months ended September 30, 2017 are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2017.

Net earnings were \$11.6 million for the nine months ended September 30, 2017, as compared to \$8.5 million for the nine months ended September 30, 2016. The following table presents key earnings data for the periods indicated:

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|   | For the Nine Months<br>Ended September<br>30,       |          |       |   |
|---|---|----------|-------|---|
|   | 2017  | 2016     |       |   |
|   | (Dollars in<br>thousands, except<br>per share data) |          |       |   |
| Net earnings                            | \$ 11,631   | \$ 8,547 |       |   |
| Net earnings per common share           |   |          |       |   |
| -basic                                  | 1.17  | 0.95     |       |   |
| -diluted                                | 1.16  | 0.95     |       |   |
| Net interest margin <sup>(1)</sup>      | 3.37  | %        | 3.25  | % |
| Net interest rate spread <sup>(2)</sup> | 3.15  | %        | 3.06  | % |
| Return on average assets                | 0.82  | %        | 0.65  | % |
| Return on average equity                | 8.74  | %        | 7.89  | % |
| Average equity to average total assets  | 9.42  | %        | 8.19  | % |
| Dividend payout ratio                   | 33.33   | %        | 27.37 | % |

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

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

#### Net Interest Income

Our operating results depend primarily on our net interest income. Fluctuations in market interest rates impact the yield and rates paid on interest-earning assets and interest-bearing liabilities, respectively. Changes in the amount and type of interest-earning assets and interest-bearing liabilities also impact our net interest income. To evaluate net interest income, we measure and monitor (1) yields on our loans and other interest-earning assets, (2) the costs of our deposits and other funding sources, (3) our net interest spread and (4) our net interest margin. Because noninterest-bearing sources of funds, such as noninterest-bearing deposits and shareholders' equity also fund interest-earning assets, net interest margin includes the benefit of these noninterest-bearing sources.

Net interest income for the nine months ended September 30, 2017 was \$44.1 million compared to \$39.8 million for the nine months ended September 30, 2016, an increase of \$4.3 million, or 10.9%. The increase in net interest income was comprised of a \$5.1 million, or 10.6%, increase in interest income offset by a \$775,000, or 9.5%, increase in interest expense. The growth in interest income was primarily attributable to a \$110.6 million, or 9.5%, increase in average loans outstanding for the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016, further improved by a 0.04% increase in the average yield on total loans. The increase in average loans outstanding was primarily due to organic growth in all of our markets and continuing maturity of de novo and acquired locations in the Dallas/Fort Worth metroplex and Bryan/College Station markets. The \$775,000 increase in interest expense for the nine months ended September 30, 2017 was primarily related to a \$74.1 million, or 6.33%, increase in average interest-bearing deposits over the same period in 2016. The majority of this increase was due to organic growth, primarily in savings and money market accounts, driven in part by favorable rates that were offered in our Bryan/College Station and Dallas/Fort Worth metroplex markets. For the nine months ended September 30, 2017, net interest margin and net interest spread were 3.37% and 3.15%, respectively, compared to 3.25% and 3.06% for the same period in 2016, which reflects the increases in interest income discussed above relative to the increases in interest expense.

#### Average Balance Sheet Amounts, Interest Earned and Yield Analysis

The following table presents an analysis of net interest income and net interest spread for the periods indicated, including average outstanding balances for each major category of interest-earning assets and interest-bearing liabilities, the interest earned or paid on such amounts, and the average rate earned or paid on such assets or liabilities, respectively. The table also sets forth the net interest margin on average total interest-earning assets for the same

periods. Interest earned on loans that are classified as nonaccrual is not recognized in income; however, the balances are reflected in average outstanding balances for the period. For the nine months ended September 30, 2017 and 2016, the amount of interest income not recognized on nonaccrual loans was not material. Any nonaccrual loans have been included in the table as loans carrying a zero yield.

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|  | For the Nine Months Ended September 30, |   |                           |                                   |   |                           |
|--|---|---|---------------------------|-----------------------------------|---|---------------------------|
|  | 2017                                    |   |                           | 2016                              |   |                           |
|  | Average<br>Outstanding<br>Balance       | Interest<br>Earned/<br>Interest<br>Paid | Average<br>Yield/<br>Rate | Average<br>Outstanding<br>Balance | Interest<br>Earned/<br>Interest<br>Paid | Average<br>Yield/<br>Rate |
| (Dollars in thousands)                         |   |   |                           |                                   |   |                           |
| <b>Assets</b>                                  |   |   |                           |                                   |   |                           |
| <b>Interest-earnings assets:</b>               |   |   |                           |                                   |   |                           |
| Total loans <sup>(1)</sup>                     | \$1,269,387                             | \$45,115                                | 4.75 %                    | \$1,158,807                       | \$40,857                                | 4.71 %                    |
| Securities available for sale                  | 216,908                                 | 3,678                                   | 2.27 %                    | 216,744                           | 3,057                                   | 1.88 %                    |
| Securities held to maturity                    | 184,269                                 | 3,340                                   | 2.42 %                    | 179,963                           | 3,549                                   | 2.63 %                    |
| Nonmarketable equity securities                | 7,012                                   | 379                                     | 7.23 %                    | 8,452                             | 193                                     | 3.05 %                    |
| Interest-bearing deposits in other banks       | 72,948                                  | 581                                     | 1.06 %                    | 74,525                            | 335                                     | 0.60 %                    |
| Total interest-earning assets                  | 1,750,524                               | \$53,093                                | 4.06 %                    | 1,638,491                         | \$47,991                                | 3.91 %                    |
| Allowance for loan losses                      | (12,040 )                               |   |                           | (10,654 )                         |   |                           |
| Noninterest-earnings assets                    | 144,937                                 |   |                           | 137,796                           |   |                           |
| Total assets                                   | \$1,883,421                             |   |                           | \$1,765,633                       |   |                           |
| <b>Liabilities and Stockholders' Equity</b>    |   |   |                           |                                   |   |                           |
| <b>Interest-bearing liabilities:</b>           |   |   |                           |                                   |   |                           |
| Interest-bearing deposits                      | \$1,243,536                             | \$7,761                                 | 0.83 %                    | \$1,169,468                       | \$6,791                                 | 0.78 %                    |
| Advances from FHLB and fed funds purchased     | 41,661                                  | 294                                     | 0.94 %                    | 65,503                            | 240                                     | 0.49 %                    |
| Other debt                                     | 8,973                                   | 300                                     | 4.48 %                    | 13,650                            | 452                                     | 4.42 %                    |
| Subordinated debentures                        | 16,607                                  | 559                                     | 4.50 %                    | 20,642                            | 656                                     | 4.25 %                    |
| Securities sold under agreements to repurchase | 12,937                                  | 37                                      | 0.38 %                    | 12,264                            | 37                                      | 0.40 %                    |
| Total interest-bearing liabilities             | 1,323,714                               | \$8,951                                 | 0.90 %                    | 1,281,527                         | \$8,176                                 | 0.85 %                    |
| <b>Noninterest-bearing liabilities:</b>        |   |   |                           |                                   |   |                           |
| Noninterest-bearing deposits                   | 375,655                                 |   |                           | 333,640                           |   |                           |
| Accrued interest and other liabilities         | 6,650                                   |   |                           | 5,939                             |   |                           |
| Total noninterest-bearing liabilities          | 382,305                                 |   |                           | 339,579                           |   |                           |
| Shareholders' equity                           | 177,402                                 |   |                           | 144,527                           |   |                           |
| Total liabilities and shareholders' equity     | \$1,883,421                             |   |                           | \$1,765,633                       |   |                           |
| Net interest rate spread <sup>(2)</sup>        |   |   | 3.15 %                    |                                   |   | 3.06 %                    |
| Net interest income                            |   | \$44,142                                |                           |                                   | \$39,815                                |                           |
| Net interest margin <sup>(3)</sup>             |   |   | 3.37 %                    |                                   |   | 3.25 %                    |

(1) Includes average outstanding balances of loans held for sale of \$3.5 million and \$3.2 million for the nine months ended September 30, 2017 and 2016, respectively.

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

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

The following table presents the change 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 interest rates. For purposes of this table, changes attributable to both rate and volume that cannot be segregated have been allocated to rate.

|  | For the Nine Months Ended<br>September 30, 2017 vs.<br>2016 |         |                                 |
|--|---|---------|---------------------------------|
|  | Increase<br>(Decrease)                                      |         |                                 |
|  | Due to Change<br>in<br>Volume                               | Rate    | Total<br>Increase<br>(Decrease) |
|  | (Dollars in thousands)                                      |         |                                 |
| <b>Interest-earning assets:</b>                |   |         |                                 |
| Total loans                                    | \$5,255   | \$(997) | \$ 4,258                        |
| Securities available for sale                  | 4   | 617     | 621                             |
| Securities held to maturity                    | 104   | (313 )  | (209 )                          |
| Nonmarketable equity securities                | (104 )  | 290     | 186                             |
| Interest-earning deposits in other banks       | (17 )   | 263     | 246                             |
| Total increase (decrease) in interest income   | \$5,242   | \$(140) | \$ 5,102                        |
| <b>Interest-bearing liabilities:</b>           |   |         |                                 |
| Interest-bearing deposits                      | \$618   | \$352   | \$ 970                          |
| Advances from FHLB and fed funds purchased     | (225 )  | 279     | 54                              |
| Other debt                                     | (209 )  | 58      | (151 )                          |
| Subordinated debentures                        | (182 )  | 84      | (98 )                           |
| Securities sold under agreements to repurchase | 3   | (3 )    | —                               |
| Total increase in interest expense             | 5   | 770     | 775                             |
| Increase (decrease) in net interest income     | \$5,237   | \$(910) | \$ 4,327                        |

#### Provision for Loan Losses

The provision for loan losses is a charge to income in order to bring our allowance for loan losses to a level deemed appropriate by management based on factors such as historical loss experience, trends in classified and past due loans, volume and growth in the loan portfolio, current economic conditions in our markets and value of the underlying collateral. Loans are charged off against the allowance for loan losses when determined appropriate. Although management believes it uses the best information available to make determinations with respect to the provision for loan losses, future adjustments may be necessary if economic conditions differ from the assumptions used in making the determination.

The provision for loan losses for the nine months ended September 30, 2017 was \$2.3 million compared to \$3.2 million for the nine months ended September 30, 2016. The decrease in the provision expense was related to one large loan relationship whose repayment ability deteriorated in the prior year, thus increasing a specific reserve allocated to the borrower during the prior year. Net charge offs were \$1.2 million for the nine months ended September 30, 2017 compared to \$1.3 million for the same period in 2016. The amount of net charge offs during the nine months ended September 30, 2017 resulted primarily from two relationships totaling approximately \$700,000, as well as smaller charge off amounts in our single family and consumer loan portfolios. The amount of net charge offs during the nine months ended September 30, 2016 resulted primarily from one relationship, totaling approximately \$1.2 million, that was charged off during the third quarter of 2016.

#### Noninterest Income

Our primary sources of recurring noninterest income are service charges on deposit accounts, merchant and debit card fees, fiduciary income, gains on the sale of loans, and income from bank-owned life insurance. Noninterest income does not include loan origination fees to the extent they exceed the direct loan origination costs, which are generally recognized over the life of the related loan as an adjustment to yield using the interest method.

The following table presents components of noninterest income for the nine months ended September 30, 2017 and 2016 and the period-over-period variations in the categories of noninterest income:

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|  | For the Nine<br>Months Ended<br>September 30, |         | Increase<br>(Decrease) |
|--|---|---------|------------------------|
|  | 2017  | 2016    | 2017 v.<br>2016        |
| (Dollars in thousands)                 |   |         |                        |
| Noninterest income:                    |   |         |                        |
| Service charges on deposit accounts    | \$2,801                                       | \$2,625 | \$ 176                 |
| Merchant and debit card fees           | 2,301   | 2,026   | 275                    |
| Fiduciary income                       | 1,055   | 1,058   | (3 )                   |
| Gain on sales of loans                 | 1,490   | 1,231   | 259                    |
| Bank-owned life insurance income       | 347   | 337     | 10                     |
| Gain on sales of investment securities | 25  | 82      | (57 )                  |
| Loan processing fee income             | 454   | 473     | (19 )                  |
| Other noninterest income               | 2,027   | 1,770   | 257                    |
| Total noninterest income               | \$10,500                                      | \$9,602 | \$ 898                 |

Total noninterest income increased \$898,000, or 9.35%, for the nine months ended September 30, 2017 compared to the same period in 2016. Material changes in the components of noninterest income are discussed below.

**Service Charges on Deposit Accounts.** We earn fees from our customers for deposit-related services, and these fees constitute a significant and predictable component of our noninterest income. Service charges on deposit accounts were \$2.8 million for the nine months ended September 30, 2017, which increased over the same period in 2016 by \$176,000, or 6.7%. This increase in service charges was due in part to our deposit growth during the same period and a new deposit service charge and fee schedule implemented during February 2017.

**Merchant and Debit Card Fees.** We earn interchange income related to the activity of our customers' merchant debit card usage. Debit card interchange income was \$2.3 million for the nine months ended September 30, 2017, compared to \$2.0 million for the same period in 2016, an increase of \$275,000, or 13.6%. The increase was primarily due to growth in the number of demand deposit accounts and debit card usage volume during 2017.

**Gain on Sales of Loans.** We originate long-term fixed-rate mortgage loans for resale into the secondary market. We sold 270 loans for \$49.4 million for the nine months ended September 30, 2017 compared to 224 loans for \$43.2 million for the nine months ended September 30, 2016. Gain on sale of loans was \$1,490,000 for the nine months ended September 30, 2017, an increase of \$259,000, or 21.0%, compared to \$1,231,000 for the same period in 2016, which reflects an increase in mortgage volume and the number of loans sold.

**Other.** This category includes a variety of other income producing activities, including mortgage loan origination fees, wire transfer fees, loan administration fees, and other fee income. Other noninterest income increased \$257,000, or 14.5%, for the nine months ended September 30, 2017, compared to the same period in 2016 due primarily to the growth in our loan portfolio and increased mortgage origination volume causing an increase in fee income generated from loan administration fees and income from mortgage loan origination and processing fees.

#### Noninterest Expense

Generally, noninterest expense is composed of all employee expenses and costs associated with operating our facilities, obtaining and retaining customer relationships and providing bank services. The largest component of noninterest expense is salaries and employee benefits. Noninterest expense also includes operational expenses, such as occupancy expenses, depreciation and amortization of our facilities and our furniture, fixtures and office equipment, professional and regulatory fees, including FDIC assessments, data processing expenses, and advertising and promotion expenses.

For the nine months ended September 30, 2017, noninterest expense totaled \$36.1 million, an increase of \$1.8 million, or 5.17%, compared to \$34.3 million for the nine months ended September 30, 2016. The following table presents, for the periods indicated, the major categories of noninterest expense:

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|                                    | For the Nine<br>Months Ended<br>September 30, |          | Increase<br>(Decrease) |
|------------------------------------|---|----------|------------------------|
|                                    | 2017  | 2016     | 2017 v.<br>2016        |
|                                    | (Dollars in thousands)                        |          |                        |
| Employee compensation and benefits | \$20,156                                      | \$19,057 | \$ 1,099               |
| Non-staff expenses:                |   |          |                        |
| Occupancy expenses                 | 5,552   | 5,196    | 356                    |
| Amortization                       | 781   | 719      | 62                     |
| Software and Technology            | 1,533   | 1,368    | 165                    |
| FDIC insurance assessment fees     | 527   | 900      | (373 )                 |
| Legal and professional fees        | 1,472   | 1,358    | 114                    |
| Advertising and promotions         | 879   | 752      | 127                    |
| Telecommunication expense          | 412   | 438      | (26 )                  |
| ATM and debit card expense         | 766   | 705      | 61                     |
| Director and committee fees        | 760   | 680      | 80                     |
| Other noninterest expense          | 3,279   | 3,167    | 112                    |
| Total noninterest expense          | \$36,117                                      | \$34,340 | \$ 1,777               |

Material changes in the components of noninterest expense are discussed below.

**Employee Compensation and Benefits.** Salaries and employee benefits are the largest component of noninterest expense and include payroll expense, the cost of incentive compensation, benefit plans, health insurance and payroll taxes. Salaries and employee benefits were \$20.2 million for the nine months ended September 30, 2017, an increase of \$1,099,000, or 5.8%, compared to \$19.1 million for the same period in 2016. The increase was due primarily to an increase in per employee salaries, as well as increased health insurance expenses, bonus expense, benefit plan expenses and payroll taxes. As of September 30, 2017 and 2016, we had 397 and 395 full-time equivalent employees, respectively, an increase of two employees.

**Occupancy Expenses.** Occupancy expenses were \$5.6 million and \$5.2 million for the nine months ended September 30, 2017 and 2016, respectively. The increase of \$356,000, or 6.9%, resulted primarily from additional lease expense of banking centers totaling \$181,000 and an increase in ad valorem taxes of \$90,000, primarily associated with repossessed assets.

**Software and Technology.** Software and technology expenses increased \$165,000, or 12.06%, from \$1.37 million for the nine months ended September 30, 2016 to \$1.53 million for the nine months ended September 30, 2017. The increase is attributable primarily to incremental processing fees resulting from growth in volume of our loan and deposit accounts.

**FDIC Insurance Assessment Fees.** FDIC assessment fees were \$527,000 and \$900,000 for the nine months ended September 30, 2017 and 2016, respectively. The decrease of \$373,000, or 41.4%, resulted from the effect of an update in our accounting methodology during 2016 related to accrual of the assessment fees and an increased one time expense in the prior period.

**Advertising and Promotions.** Advertising and promotion related expenses were \$879,000 and \$752,000 for the nine months ended September 30, 2017 and 2016, respectively. The increase of \$127,000, or 16.9%, was primarily due to increases in advertising expense in our growth markets, especially Dallas/Fort Worth and Bryan/College Station.

**Other.** This category includes operating and administrative expenses, such as stock option expense, expenses and losses related to repossession of assets, small hardware and software purchases, expense of the value of stock appreciation rights, losses incurred on problem assets, OREO related expenses, gains or losses on the sale of OREO, business development expenses (i.e., travel and entertainment, charitable contributions and club memberships), insurance and security expenses. Other noninterest expense increased to \$3.3 million for the nine months ended September 30, 2017, compared to \$3.2 million for the same period in 2016, an increase of \$112,000, or 3.5%. The

increase was primarily due to additional stock appreciation rights and stock option expenses of \$306,000 during the

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comparable periods, partially offset by a decrease in loan and filing fee expenses of \$168,000 during the comparable periods, resulting from both processing efficiencies and a reduction in appraisal review costs by reviewing the appraisals internally, rather than through a third party vendor.

#### Income Tax Expense

The amount of income tax expense we incur is influenced by the amounts of our 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.

For the nine months ended September 30, 2017 and 2016, income tax expense totaled \$4.6 million and \$3.3 million, respectively. Our effective tax rates for the nine months ended September 30, 2017 and 2016 were 28.54% and 27.79%, respectively.

#### Discussion and Analysis of Results of Operations for the Three Months Ended September 30, 2017 and 2016 Results of Operations

The following discussion and analysis of our results of operations compares our results of operations for the three months ended September 30, 2017 with the three months ended September 30, 2016. The results of operations for the three months ended September 30, 2017 are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2017.

Net earnings were \$4.1 million for the three months ended September 30, 2017, as compared to \$3.4 million for the three months ended September 30, 2016. The following table presents key earnings data for the periods indicated:

|   | For the Three<br>Months Ended<br>September 30,<br>2017 |   | 2016    |   |
|---|--|---|---------|---|
|   | (Dollars in<br>thousands, except<br>per share data)    |   |         |   |
| Net earnings                            | \$4,139  |   | \$3,370 |   |
| Net earnings per common share           |  |   |         |   |
| -basic                                  | 0.37   |   | 0.38    |   |
| -diluted                                | 0.37   |   | 0.38    |   |
| Net interest margin <sup>(1)</sup>      | 3.38   | % | 3.26    | % |
| Net interest rate spread <sup>(2)</sup> | 3.13   | % | 3.07    | % |
| Return on average assets                | 0.87   | % | 0.75    | % |
| Return on average equity                | 7.99   | % | 9.20    | % |
| Average equity to average total assets  | 10.86  | % | 8.16    | % |

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

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

#### Net Interest Income

Net interest income for the three months ended September 30, 2017 was \$15.1 million compared to \$13.7 million for the three months ended September 30, 2016, an increase of \$1.4 million, or 10.5%. The increase in net interest income was comprised of a \$1.7 million, or 10.6%, increase in interest income offset by a \$304,000, or 11.0%, increase in interest expense. The growth in interest income was primarily attributable to a \$76.7 million, or 6.3%, increase in average loans outstanding for the three months ended September 30, 2017, compared to the three months ended September 30, 2016, and further improved by a 0.07% increase in the average yield on total loans. The increase in average loans outstanding was primarily due to organic growth in all of our markets and continuing maturity of de novo and acquired locations in the Dallas/Fort Worth metroplex and Bryan/College Station markets. The \$304,000



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increase in interest expense for the three months ended September 30, 2017 was primarily related to a \$62.9 million, or 5.4%, increase in average interest-bearing deposits over the same period in 2016, and an increase in the average rate of 0.08%. The majority of this increase was due to organic growth, primarily in money market accounts, driven in part by favorable rates that were offered in our Bryan/College Station and Dallas/Fort Worth metroplex markets. For the three months ended September 30, 2017, net interest margin and net interest spread were 3.38% and 3.13%, respectively, compared to 3.26% and 3.07% for the same period in 2016, which reflects the increases in interest income discussed above relative to the increases in interest expense.

#### Average Balance Sheet Amounts, Interest Earned and Yield Analysis

The following table presents an analysis of net interest income and net interest spread for the periods indicated, including average outstanding balances for each each major category of interest-earning assets and interest-bearing liabilities, the interest earned or paid on such amounts, and the average rate earned or paid on such assets or liabilities, respectively. The table also sets forth the net interest margin on average total interest-earning assets for the same periods. Interest earned on loans that are classified as nonaccrual is not recognized in income; however the balances are reflected in average outstanding balances for the period. For the three months ended September 30, 2017 and 2016, the amount of interest income not recognized on nonaccrual loans was not material. Any nonaccrual loans have been included in the table as loans carrying a zero yield.

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|  | For the Three Months Ended September 30, |                                |                     |                             |                                |                     |  |  |
|--|--|--------------------------------|---------------------|-----------------------------|--------------------------------|---------------------|--|--|
|  | 2017                                     |                                | 2016                |                             |                                |                     |  |  |
|  | Average Outstanding Balance              | Interest Earned/ Interest Paid | Average Yield/ Rate | Average Outstanding Balance | Interest Earned/ Interest Paid | Average Yield/ Rate |  |  |
| (Dollars in thousands)                         |  |                                |                     |                             |                                |                     |  |  |
| Assets   |  |                                |                     |                             |                                |                     |  |  |
| Interest-earnings assets:                      |  |                                |                     |                             |                                |                     |  |  |
| Total loans <sup>(1)</sup>                     | \$1,300,307                              | \$15,486                       | 4.72 %              | \$1,223,611                 | \$14,294                       | 4.65 %              |  |  |
| Securities available for sale                  | 245,409                                  | 1,376                          | 2.22 %              | 163,563                     | 709                            | 1.72 %              |  |  |
| Securities held to maturity                    | 180,737                                  | 1,088                          | 2.39 %              | 196,003                     | 1,252                          | 2.54 %              |  |  |
| Nonmarketable equity securities                | 6,541                                    | 59                             | 3.58 %              | 8,816                       | 61                             | 2.75 %              |  |  |
| Interest-bearing deposits in other banks       | 40,997                                   | 156                            | 1.51 %              | 75,112                      | 111                            | 0.59 %              |  |  |
| Total interest-earning assets                  | 1,773,991                                | \$18,165                       | 4.06 %              | 1,667,105                   | \$16,427                       | 3.92 %              |  |  |
| Allowance for loan losses                      | (12,492 )                                |                                |                     | (11,843 )                   |                                |                     |  |  |
| Noninterest-earnings assets                    | 145,958                                  |                                |                     | 140,087                     |                                |                     |  |  |
| Total assets                                   | \$1,907,457                              |                                |                     | \$1,795,349                 |                                |                     |  |  |
| Liabilities and Stockholders' Equity           |  |                                |                     |                             |                                |                     |  |  |
| Interest-bearing liabilities:                  |  |                                |                     |                             |                                |                     |  |  |
| Interest-bearing deposits                      | \$1,224,991                              | \$2,730                        | 0.88 %              | \$1,162,060                 | \$2,329                        | 0.80 %              |  |  |
| Advances from FHLB and fed funds purchased     | 50,420                                   | 157                            | 1.24 %              | 93,001                      | 97                             | 0.41 %              |  |  |
| Other debt                                     | —  | —                              | — %                 | 10,000                      | 104                            | 4.14 %              |  |  |
| Subordinated debentures                        | 13,821                                   | 164                            | 4.71 %              | 20,310                      | 217                            | 4.25 %              |  |  |
| Securities sold under agreements to repurchase | 14,262                                   | 12                             | 0.33 %              | 11,952                      | 12                             | 0.40 %              |  |  |
| Total interest-bearing liabilities             | 1,303,494                                | \$3,063                        | 0.93 %              | 1,297,323                   | \$2,759                        | 0.85 %              |  |  |
| Noninterest-bearing liabilities:               |  |                                |                     |                             |                                |                     |  |  |
| Noninterest-bearing deposits                   | 390,043                                  |                                |                     | 344,721                     |                                |                     |  |  |
| Accrued interest and other liabilities         | 6,798                                    |                                |                     | 6,752                       |                                |                     |  |  |
| Total noninterest-bearing liabilities          | 396,841                                  |                                |                     | 351,473                     |                                |                     |  |  |
| Shareholders' equity                           | 207,122                                  |                                |                     | 146,553                     |                                |                     |  |  |
| Total liabilities and shareholders' equity     | \$1,907,457                              |                                |                     | \$1,795,349                 |                                |                     |  |  |
| Net interest rate spread <sup>(2)</sup>        |  |                                | 3.13 %              |                             |                                | 3.07 %              |  |  |
| Net interest income                            |  | \$15,102                       |                     |                             | \$13,668                       |                     |  |  |
| Net interest margin <sup>(3)</sup>             |  |                                | 3.38 %              |                             |                                | 3.26 %              |  |  |

(1) Includes average outstanding balances of loans held for sale of \$2.1 million and \$1.7 million for the three months ended September 30, 2017 and 2016, respectively.

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

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

The following table presents the change 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 interest rates. For purposes of this table, changes attributable to both rate and volume that cannot be segregated have been allocated to rate.

|  | For the Three Months Ended<br>September 30, 2017 vs. 2016 |           |                                 |
|--|---|-----------|---------------------------------|
|  | Increase<br>(Decrease)                                    |           |                                 |
|  | Due to Change in<br>Volume                                | Rate      | Total<br>Increase<br>(Decrease) |
|  | (Dollars in thousands)                                    |           |                                 |
| <b>Interest-earning assets:</b>                |   |           |                                 |
| Total loans                                    | \$3,624   | \$(2,432) | \$ 1,192                        |
| Securities available for sale                  | 1,821   | (1,154 )  | 667                             |
| Securities held to maturity                    | (365 )  | 201       | (164 )                          |
| Nonmarketable equity securities                | (81 )   | 79        | (2 )                            |
| Interest-earning deposits in other banks       | (515 )  | 560       | 45                              |
| Total increase (decrease) in interest income   | \$4,484   | \$(2,746) | \$ 1,738                        |
| <b>Interest-bearing liabilities:</b>           |   |           |                                 |
| Interest-bearing deposits                      | \$556   | \$(155 )  | \$ 401                          |
| Advances from FHLB and fed funds purchased     | (526 )  | 586       | 60                              |
| Other debt                                     | —   | (104 )    | (104 )                          |
| Subordinated debentures                        | (305 )  | 252       | (53 )                           |
| Securities sold under agreements to repurchase | 8   | (8 )      | —                               |
| Total increase (decrease) in interest expense  | (267 )  | 571       | 304                             |
| Increase (decrease) in net interest income     | \$4,751   | \$(3,317) | \$ 1,434                        |

**Provision for Loan Losses**

The provision for loan losses for the three months ended September 30, 2017 was \$800,000 compared to \$840,000 for the three months ended September 30, 2016. Net charge offs were \$1.0 million for the three months ended September 30, 2017 compared to \$1.3 million for the same period in 2016. Two relationships totaling approximately \$700,000 were charged off during the third quarter of 2017 and one relationship totaling approximately \$1.2 million was charged off during the third quarter of 2016.

**Noninterest Income**

The following table presents components of noninterest income for the three months ended September 30, 2017 and 2016 and the period-over-period variations in the categories of noninterest income:

|   | For the Three<br>Months Ended<br>September 30, |       |                 |
|---|--|-------|-----------------|
|   | Increase<br>(Decrease)                         |       |                 |
|   | 2017   | 2016  | 2017 v.<br>2016 |
|   | (Dollars in thousands)                         |       |                 |
| <b>Noninterest income:</b>                    |  |       |                 |
| Service charges on deposit accounts           | \$986  | \$914 | \$ 72           |
| Merchant and debit card fees                  | 778  | 690   | 88              |
| Fiduciary income                              | 362  | 364   | (2 )            |
| Gain on sales of loans                        | 589  | 486   | 103             |
| Bank-owned life insurance income              | 116  | 112   | 4               |
| Gain (loss) on sales of investment securities | —  | 64    | (64 )           |
| Loan processing fee income                    | 146  | 161   | (15 )           |
| Other noninterest income                      | 725  | 611   | 114             |

|                          |         |         |        |
|--------------------------|---------|---------|--------|
| Total noninterest income | \$3,702 | \$3,402 | \$ 300 |
|--------------------------|---------|---------|--------|

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Total noninterest income increased \$300,000, or 8.8%, for the three months ended September 30, 2017 compared to the same period in 2016. Material changes in the components of noninterest income are discussed below.

**Service Charges on Deposit Accounts.** We earn fees from our customers for deposit-related services, and these fees constitute a significant and predictable component of our noninterest income. Service charges on deposit accounts were \$986,000 for the three months ended September 30, 2017, which increased over the same period in 2016 by \$72,000, or 7.9%. This increase in service charges was due in part to our deposit growth during the same period and a new deposit service charge and fee schedule implemented during February 2017.

**Merchant and Debit Card Fees.** We earn interchange income related to the activity of our customers' merchant debit card usage. Debit card interchange income was \$778,000 for the three months ended September 30, 2017 compared to \$690,000 for the same period in 2016, an increase of \$88,000, or 12.8%. The increase was primarily due to growth in the number of demand deposit accounts and debit card usage volume during 2017.

**Gain on Sale of Loans.** We originate long-term fixed-rate mortgage loans for resale into the secondary market. We sold 109 loans for \$19.9 million for the three months ended September 30, 2017 compared to 92 loans for \$16.2 million for the three months ended September 30, 2016. Gain on sale of loans was \$589,000 for the three months ended September 30, 2017, an increase of \$103,000, or 21.2%, compared to \$486,000 for the same period in 2016, which reflects an increase in mortgage volume and the number of loans sold.

**Other.** This category includes a variety of other income producing activities, including mortgage loan origination fees, wire transfer fees, loan administration fees, and other fee income. Other noninterest income increased \$114,000, or 18.7%, for the three months ended September 30, 2017 compared to the same period in 2016 due primarily to the growth in our loan portfolio and increased mortgage origination volume causing an increase in fee income generated from loan administration fees and income from mortgage loan origination and processing fees.

#### Noninterest Expense

For the three months ended September 30, 2017, noninterest expense totaled \$12.2 million, an increase of \$686,000, or 6.0%, compared to \$11.5 million for the three months ended September 30, 2016. The following table presents, for the periods indicated, the major categories of noninterest expense:

|                                    | For the Three<br>Months Ended<br>September 30, |          | Increase<br>(Decrease) |
|------------------------------------|--|----------|------------------------|
|                                    | 2017   | 2016     | 2017 v.<br>2016        |
|                                    | (Dollars in thousands)                         |          |                        |
| Employee compensation and benefits | \$6,729  | \$6,370  | \$ 359                 |
| Non-staff expenses:                |  |          |                        |
| Occupancy expenses                 | 1,938  | 1,720    | 218                    |
| Amortization                       | 258  | 240      | 18                     |
| Software and Technology            | 533  | 451      | 82                     |
| FDIC insurance assessment fees     | 162  | 300      | (138 )                 |
| Legal and professional fees        | 692  | 481      | 211                    |
| Advertising and promotions         | 303  | 278      | 25                     |
| Telecommunication expense          | 128  | 130      | (2 )                   |
| ATM and debit card expense         | 253  | 203      | 50                     |
| Director and committee fees        | 253  | 222      | 31                     |
| Other noninterest expense          | 917  | 1,085    | (168 )                 |
| Total noninterest expense          | \$12,166                                       | \$11,480 | \$ 686                 |

Material changes in the components of noninterest expense are discussed below.

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**Employee Compensation and Benefits.** Salaries and employee benefits are the largest component of noninterest expense and include payroll expense, the cost of incentive compensation, benefit plans, health insurance and payroll taxes. Salaries and employee benefits were \$6.7 million for the three months ended September 30, 2017, an increase of \$359,000, or 5.6%, compared to \$6.4 million for the same period in 2016. The increase was due primarily to an increase in per employee salaries, as well as increased health insurance expenses, benefit plan expenses and payroll taxes. As of September 30, 2017 and 2016, we had 397 and 395 full-time equivalent employees, respectively, an increase of two employees.

**Occupancy Expenses.** Occupancy expenses were \$1.9 million and \$1.7 million for the three months ended September 30, 2017 and 2016, respectively. The increase of \$218,000, or 12.7%, resulted primarily from additional lease expense of banking centers and an increase during the quarter of machine and equipment servicing expenses related to automated teller machines and banking center alarm systems.

**Software and Technology Fees.** Software and technology fees consist of fees paid to third parties for support of software and technology products. Software support fee expense was \$533,000 for the three months ended September 30, 2017, compared to \$451,000 for the same period in 2016, an increase of \$82,000, or 18.2%. The increase resulted primarily from general increases in support and technology contract costs.

**FDIC Insurance Assessment Fees.** FDIC assessment fees were \$162,000 and \$300,000 for the three months ended September 30, 2017 and 2016, respectively. The decrease of \$138,000, or 46.0%, resulted from the effect of an update in our accounting methodology during 2016 related to accrual of the assessment fees and an increased one time expense in the prior period.

**Other.** This category includes operating and administrative expenses, such as stock option expense, expenses and losses related to repossession of assets, small hardware and software purchases, expense of the value of stock appreciation rights, losses incurred on problem assets, OREO related expenses, gains or losses on the sale of OREO, business development expenses (i.e., travel and entertainment, charitable contributions and club memberships), insurance and security expenses. Other noninterest expense decreased to \$917,000 for the three months ended September 30, 2017, compared to \$1.1 million for the same period in 2016, a decrease of \$168,000, or 15.48%. The decrease was primarily due to reductions in office and computer supplies, account promotion expense and loan and filing expenses, quarter-over-quarter, partially offset by an increase in liability insurance expense.

#### Income Tax Expense

For the three months ended September 30, 2017 and 2016, income tax expense totaled \$1.7 million and \$1.4 million, respectively. Our effective tax rates for the three months ended September 30, 2017 and 2016, were 29.10% and 29.05%, respectively.

#### Discussion and Analysis of Financial Condition as of September 30, 2017

##### Assets

Our total assets increased \$95.7 million, or 5.2%, from \$1.8 billion as of December 31, 2016 to \$1.9 billion as of September 30, 2017. Our asset growth was primarily due to increases in our loan and securities portfolios, offset by decreases in cash and other assets.

##### Loan Portfolio

Our primary source of income is derived through interest earned on loans to small- to medium-sized businesses, commercial companies, professionals and individuals located in our primary market areas. A substantial portion of our loan portfolio consists of commercial and industrial loans and real estate loans secured by commercial real estate properties located in our primary market areas. Our loan portfolio represents the highest yielding component of our earning asset base.

Our loan portfolio is the largest category of our earning assets. As of September 30, 2017, total loans were \$1.31 billion, an increase of \$62.2 million, or 5.0%, from the December 31, 2016 balance of \$1.25 billion. In addition to these amounts, \$3.4 million and \$2.6 million in loans were classified as held for sale as of September 30, 2017 and December 31, 2016, respectively.



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Total loans, excluding those held for sale, as a percentage of deposits, were 80.8% and 79.0% as of September 30, 2017 and December 31, 2016, respectively. Total loans, excluding those held for sale, as a percentage of total assets, were 67.9% and 68.1% as of September 30, 2017 and December 31, 2016, respectively.

The following table summarizes our loan portfolio by type of loan and dollar and percentage change from December 31, 2016 to September 30, 2017:

|                                 | As of<br>September 30,<br>2017 | As of<br>December 31,<br>2016 | Dollar<br>Change | Percent<br>Change |
|---------------------------------|--------------------------------|-------------------------------|------------------|-------------------|
|                                 | (Dollars in thousands)         |                               |                  |                   |
| Commercial and industrial       | \$ 192,663                     | \$ 223,997                    | \$(31,334)       | (13.99)%          |
| Real estate:                    |                                |                               |                  |                   |
| Construction and development    | 201,067                        | 129,366                       | 71,701           | 55.42 %           |
| Commercial real estate          | 393,314                        | 367,656                       | 25,658           | 6.98 %            |
| Farmland                        | 54,349                         | 62,362                        | (8,013 )         | (12.85)%          |
| 1-4 family residential          | 365,889                        | 362,952                       | 2,937            | 0.81 %            |
| Multi-family residential        | 23,235                         | 26,079                        | (2,844 )         | (10.91)%          |
| Consumer and overdrafts         | 52,409                         | 53,822                        | (1,413 )         | (2.63 )%          |
| Agricultural                    | 24,449                         | 18,901                        | 5,548            | 29.35 %           |
| Total loans held for investment | \$ 1,307,375                   | \$ 1,245,135                  | \$ 62,240        | 5.00 %            |
| Total loans held for sale       | \$ 3,400                       | \$ 2,563                      | \$ 837           | 32.66 %           |

#### Nonperforming Assets

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on nonaccrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on nonaccrual status regardless of whether or not such loans are considered past due. In general, we place loans on nonaccrual status when they become 90 days past due. We also place loans on nonaccrual status if they are less than 90 days past due if the collection of principal or interest is in doubt. When interest accrual is discontinued, all unpaid accrued interest is reversed from income. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are, in management's opinion, reasonably assured.

We believe our conservative lending approach and focused management of nonperforming assets has resulted in sound asset quality and timely resolution of problem assets. We have several procedures in place to assist us in maintaining the overall quality of our loan portfolio. We have established underwriting guidelines to be followed by our bankers, and we also monitor our delinquency levels for any negative or adverse trends. There can be no assurance, however, that our loan portfolio will not become subject to increasing pressures from deteriorating borrower credit due to general economic conditions.

We had \$10.2 million in nonperforming assets as of September 30, 2017, compared to \$9.6 million as of December 31, 2016. We had \$5.8 million in nonperforming loans as of September 30, 2017, compared to \$4.4 million as of December 31, 2016. The \$1.3 million, or 30.5%, increase in our nonperforming (nonaccrual) loans from December 31, 2016 to September 30, 2017 primarily relates to an increase in nonaccrual loans in our 1-4 family residential portfolio of \$1.0 million, of which \$612,000 is related to one borrower and several loans that are in the process of foreclosure. We also had an increase in our nonaccrual commercial real estate portfolio of \$1.7 million, of which \$1.5 million is related to two borrowers. The increase in nonaccrual loans was partially offset by a decrease in our construction and development nonaccrual portfolio, all of which was attributable to one borrower that was returned to accrual status in accordance with our loan policy.

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The following table presents information regarding nonperforming assets and loans as of:

|  | September 30,<br>2017  | December 31,<br>2016 |   |
|--|------------------------|----------------------|---|
|  | (Dollars in thousands) |                      |   |
| Nonaccrual loans   | \$5,755                | \$ 4,409             |   |
| Accruing loans 90 or more days past due                            | —                      | —                    |   |
| Total nonperforming loans  | 5,755                  | 4,409                |   |
| Other real estate owned:   |                        |                      |   |
| Commercial real estate, construction and development, and farmland | 1,003                  | 1,074                |   |
| Residential real estate  | 926                    | 618                  |   |
| Total other real estate owned                                      | 1,929                  | 1,692                |   |
| Reposessed assets owned  | 2,479                  | 3,530                |   |
| Total other assets owned   | 4,408                  | 5,222                |   |
| Total nonperforming assets   | \$10,163               | \$ 9,631             |   |
| Restructured loans-nonaccrual                                      | \$—                    | \$ 43                |   |
| Restructured loans-accruing  | 316                    | 462                  |   |
| Ratio of nonperforming loans to total loans <sup>(1)(2)</sup>      | 0.44                   | % 0.35               | % |
| Ratio of nonperforming assets to total assets                      | 0.53                   | % 0.53               | % |

(1) Excludes loans held for sale of \$3.4 million and \$2.6 million as of September 30, 2017 and December 31, 2016, respectively.

(2) Restructured loans-nonaccrual are included in nonaccrual loans which are a component of nonperforming loans.

The following table presents nonaccrual loans by category as of:

|                               | September 30,<br>2017  | December 31,<br>2016 |
|-------------------------------|------------------------|----------------------|
|                               | (Dollars in thousands) |                      |
| Nonaccrual loans by category: |                        |                      |
| Real estate:                  |                        |                      |
| Construction and development  | \$—                    | \$ 1,825             |
| Commercial real estate        | 2,113                  | 415                  |
| Farmland                      | 162                    | 176                  |
| 1-4 family residential        | 2,716                  | 1,699                |
| Multi-family residential      | 228                    | 5                    |
| Commercial and industrial     | 57                     | 82                   |
| Consumer                      | 164                    | 192                  |
| Agricultural                  | 315                    | 15                   |
| Total                         | \$5,755                | \$ 4,409             |

#### Potential Problem Loans

From a credit risk standpoint, we classify loans in one of five categories: pass, special mention, substandard, doubtful or loss. Within the pass category, we classify loans into one of the following four subcategories based on perceived credit risk, including repayment capacity and collateral security: superior, excellent, good and acceptable. The classifications of loans reflect a judgment about the risks of default and loss associated with the loan. We review the ratings on credits monthly. Ratings are adjusted to reflect the degree of risk and loss that is believed to be inherent in each credit as of each monthly reporting period. Our methodology is structured so that specific reserve allocations are increased in accordance with deterioration in credit quality (and a corresponding increase in risk and loss) or decreased in accordance with improvement in credit quality (and a corresponding decrease in risk and loss).

Credits rated special mention show clear signs of financial weaknesses or deterioration in creditworthiness; however, such concerns are not so pronounced that we generally expect to experience significant loss within the short-

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term. Such credits typically maintain the ability to perform within standard credit terms and credit exposure is not as prominent as credits with a lower rating. The increase in special mention loans from December 31, 2016 to September 30, 2017 is attributable to one borrower, with an outstanding balance of \$19.0 million, whose cash flow was adversely impacted by hurricane Harvey, thus was added to our special mention/watch list until the cash flow returns to normal levels. The physical collateral was not impacted and we do not expect any long term impairment or losses as a result of the hurricane for this loan.

Credits rated substandard are those in which the normal repayment of principal and interest may be, or has been, jeopardized by reason of adverse trends or developments of a financial, managerial, economic or political nature, or important weaknesses which exist in collateral. A protracted workout on these credits is a distinct possibility. Prompt corrective action is therefore required to reduce exposure and to assure that adequate remedial measures are taken by the borrower. Credit exposure becomes more likely in such credits and a serious evaluation of the secondary support to the credit is performed.

Credits rated as doubtful have the weaknesses of substandard assets with the additional characteristic that the weaknesses make collection or liquidation in full questionable and there is a high probability of loss based on currently existing facts, conditions and values.

Credits rated as loss are charged-off. We have no expectation of the recovery of any payments in respect of credits rated as loss.

The following tables summarize the internal ratings of our loans as of:

September 30, 2017

| Pass | Special<br>Mention | Substandard | Doubtful | Loss | Total |
|------|--------------------|-------------|----------|------|-------|
|------|--------------------|-------------|----------|------|-------|

(Dollars in thousands)

Real estate:

|                              |             |           |          |      |         |              |
|------------------------------|-------------|-----------|----------|------|---------|--------------|
| Construction and development | \$ 181,879  | \$ 19,188 | \$ —     | \$ — | —\$ —\$ | —\$201,067   |
| Commercial real estate       | 388,007     | 1,030     | 4,277    | —    | —       | 393,314      |
| Farmland                     | 53,649      | 413       | 287      | —    | —       | 54,349       |
| 1-4 family residential       | 357,814     | 3,059     | 5,016    | —    | —       | 365,889      |
| Multi-family residential     | 21,659      | 1,348     | 228      | —    | —       | 23,235       |
| Commercial and industrial    | 188,440     | 3,705     | 518      | —    | —       | 192,663      |
| Consumer and overdrafts      | 51,631      | 362       | 416      | —    | —       | 52,409       |
| Agricultural                 | 22,525      | 1,147     | 777      | —    | —       | 24,449       |
| Total                        | \$1,265,604 | \$30,252  | \$11,519 | \$ — | —\$     | —\$1,307,375 |

December 31, 2016

| Pass | Special<br>Mention | Substandard | Doubtful | Loss | Total |
|------|--------------------|-------------|----------|------|-------|
|------|--------------------|-------------|----------|------|-------|

(Dollars in thousands)

Real estate:

|                              |             |          |          |        |      |              |
|------------------------------|-------------|----------|----------|--------|------|--------------|
| Construction and development | \$ 127,537  | \$ 4     | \$ 1,825 | \$ —   | \$ — | —\$129,366   |
| Commercial real estate       | 360,264     | 1,927    | 5,465    | —      | —    | 367,656      |
| Farmland                     | 61,713      | 248      | 401      | —      | —    | 62,362       |
| 1-4 family residential       | 353,483     | 4,311    | 5,121    | 37     | —    | 362,952      |
| Multi-family residential     | 25,871      | —        | 208      | —      | —    | 26,079       |
| Commercial and industrial    | 218,975     | 4,299    | 706      | 17     | —    | 223,997      |
| Consumer and overdrafts      | 52,648      | 524      | 568      | 82     | —    | 53,822       |
| Agricultural                 | 17,965      | 478      | 458      | —      | —    | 18,901       |
| Total                        | \$1,218,456 | \$11,791 | \$14,752 | \$ 136 | \$ — | —\$1,245,135 |



#### Allowance for Loan Losses

We maintain an allowance for loan losses that represents management's best estimate of the loan losses and risks inherent in our 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, or at all. In determining the allowance for loan losses, we estimate 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 nature of our 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. Please see "-Critical Accounting Policies-Allowance for Loan Losses."

In connection with the review of our loan portfolio, we consider risk elements attributable to particular loan types or categories in assessing the quality of individual loans. Some of the risk elements we consider include:

for 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;

for commercial mortgage loans and multifamily 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;

for 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

for 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.

As of September 30, 2017, the allowance for loan losses totaled \$12.5 million, or 0.96%, of total loans, excluding those held for sale. As of December 31, 2016, the allowance for loan losses totaled \$11.5 million, or 0.92%, of total loans, excluding those held for sale. The increase in allowance is due to general reserves for organic loan growth, specific allocations on impaired assets and slightly higher qualitative factors in general allocation in recognition of certain macroeconomic trends in consumer and commercial real estate lending.



The following table presents, as of and for the periods indicated, an analysis of the allowance for loan losses and other related data:

|  | For the Nine Months Ended |             | For the Year      |
|--|---------------------------|-------------|-------------------|
|  | September 30,             |             | Ended             |
|  | 2017                      | 2016        | December 31, 2016 |
|  | (Dollars in thousands)    |             |                   |
| Average loans outstanding <sup>(1)</sup>                 | \$1,269,387               | \$1,158,807 | \$1,179,938       |
| Gross loans outstanding at end of period <sup>(2)</sup>  | \$1,307,375               | \$1,229,341 | \$1,245,135       |
| Allowance for loan losses at beginning of the period     | 11,484                    | 9,263       | 9,263             |
| Provision for loan losses                                | 2,250                     | 3,240       | 3,640             |
| Charge-offs:   |                           |             |                   |
| Real Estate:   |                           |             |                   |
| Construction and development                             | —                         | 9           | 9                 |
| Commercial real estate                                   | 84                        | —           | —                 |
| Farmland   | —                         | —           | —                 |
| 1-4 family residential                                   | 307                       | 25          | 71                |
| Multi-family residential                                 | —                         | —           | —                 |
| Commercial and industrial                                | 737                       | 1,196       | 1,213             |
| Consumer   | 230                       | 170         | 269               |
| Agriculture  | 4                         | —           | —                 |
| Overdrafts   | 117                       | 119         | 200               |
| Total charge-offs  | 1,479                     | 1,519       | 1,762             |
| Recoveries:  |                           |             |                   |
| Real Estate:   |                           |             |                   |
| Construction and development                             | —                         | 4           | 4                 |
| Commercial real estate                                   | —                         | —           | —                 |
| Farmland   | —                         | —           | —                 |
| 1-4 family residential                                   | 21                        | —           | 75                |
| Multi-family residential                                 | —                         | —           | —                 |
| Commercial and industrial                                | 116                       | 14          | 17                |
| Consumer   | 95                        | 103         | 121               |
| Agriculture  | —                         | —           | —                 |
| Overdrafts   | 41                        | 61          | 126               |
| Total recoveries   | 273                       | 182         | 343               |
| Net charge-offs  | 1,206                     | 1,337       | 1,419             |
| Allowance for loan losses at end of period               | \$12,528                  | \$11,166    | \$11,484          |
| Ratio of allowance to end of period loans <sup>(2)</sup> | 0.96                      | % 0.91      | % 0.92            |
| Ratio of net charge-offs to average loans <sup>(1)</sup> | 0.13                      | % 0.15      | % 0.12            |

(1) Includes average outstanding balances of loans held for sale of \$2.8 million, \$3.0 million and \$3.0 million for the nine months ended September 30, 2017 and 2016 and for the year ended December 31, 2016, respectively.

(2) Excludes loans held for sale of \$3.4 million, \$3.1 million and \$2.6 million for the nine months ended September 30, 2017 and 2016 and for the year ended December 31, 2016, respectively.

The allowance for loan losses to non-performing loans has decreased from 260.5% at December 31, 2016 to 217.7% at September 30, 2017. Non-performing loans increased to \$5.8 million at September 30, 2017 compared to \$4.4 million at December 31, 2016, which is attributable primarily to an increases in nonaccrual loans in our 1-4 family residential and commercial real estate portfolios, and partially offset by a decrease in nonaccrual loans in our

construction and development portfolio.

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Although we believe that we have established our allowance for loan losses in accordance with GAAP and that the allowance for loan losses was adequate to provide for known and inherent losses in the portfolio at all times shown above, future provisions for loan losses will be subject to ongoing evaluations of the risks in our loan portfolio. If our primary market areas experience economic declines, if asset quality deteriorates or if we are successful in growing the size of our loan portfolio, our allowance could become inadequate and material additional provisions for loan losses could be required.

The following table shows the allocation of the allowance for loan losses among loan categories and certain other information as of the dates indicated. The allocation of the allowance for loan losses as shown in the table should neither be interpreted as an indication of future charge-offs, nor as an indication that charge-offs in future periods will necessarily occur in these amounts or in the indicated proportions. The total allowance is available to absorb losses from any loan category.

|                                 | As of<br>September 30,<br>2017 |                                 | As of<br>December 31,<br>2016 |                                 |
|---------------------------------|--------------------------------|---------------------------------|-------------------------------|---------------------------------|
|                                 | Amount                         | Percent<br>to<br>Total<br>Loans | Amount                        | Percent<br>to<br>Total<br>Loans |
| (Dollars in thousands)          |                                |                                 |                               |                                 |
| Real estate:                    |                                |                                 |                               |                                 |
| Construction and development    | \$1,923                        | 0.15 %                          | \$1,161                       | 0.09 %                          |
| Commercial real estate          | 4,199                          | 0.32 %                          | 3,264                         | 0.26 %                          |
| Farmland                        | 458                            | 0.04 %                          | 482                           | 0.04 %                          |
| 1-4 family residential          | 3,089                          | 0.24 %                          | 3,960                         | 0.32 %                          |
| Multi-family residential        | 266                            | 0.02 %                          | 281                           | 0.02 %                          |
| Total real estate               | 9,935                          | 0.77 %                          | 9,148                         | 0.73 %                          |
| Commercial and industrial       | 1,573                          | 0.12 %                          | 1,592                         | 0.13 %                          |
| Consumer                        | 613                            | 0.05 %                          | 591                           | 0.05 %                          |
| Agricultural                    | 407                            | 0.03 %                          | 153                           | 0.01 %                          |
| Total allowance for loan losses | \$12,528                       | 0.97 %                          | \$11,484                      | 0.92 %                          |

#### Securities

We use our securities portfolio to provide a source of liquidity, provide an appropriate return on funds invested, manage interest rate risk, meet collateral requirements and meet regulatory capital requirements. As of September 30, 2017, the carrying amount of our investment securities totaled \$417.2 million, an increase of \$70.9 million, or 20.5%, compared to \$346.3 million as of December 31, 2016. Investment securities represented 21.7% and 18.9% of total assets as of September 30, 2017 and December 31, 2016, respectively.

Our investment portfolio consists of securities classified as available for sale and held to maturity. As of September 30, 2017, securities available for sale and securities held to maturity totaled \$238.1 million and \$179.1 million, respectively. As of December 31, 2016, securities available for sale and securities in held to maturity totaled \$156.9 million and \$189.4 million, respectively. Held to maturity percentages represented 42.9% of our investment portfolio as of September 30, 2017 and 54.7% as of December 31, 2016. While we generally seek to maintain 50.0% or less of our portfolio in held to maturity securities, the Company has the intent and ability to hold its held to maturity securities until maturity or call and the December 31, 2016 policy exception was approved by our board of directors. The carrying values of our investment securities classified as available for sale are adjusted for unrealized gain or loss, and any gain or loss is reported on an after-tax basis as a component of other comprehensive income in shareholders' equity.

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The following tables summarize the amortized cost and estimated fair value of our investment securities:

| As of September 30, 2017            |                   |                              |                               |               |
|-------------------------------------|-------------------|------------------------------|-------------------------------|---------------|
|                                     | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
| (Dollars in thousands)              |                   |                              |                               |               |
| Corporate bonds                     | \$18,842          | \$ 178                       | \$ —                          | \$19,020      |
| Municipal securities                | 154,762           | 2,696                        | 821                           | 156,637       |
| Mortgage-backed securities          | 115,138           | 298                          | 929                           | 114,507       |
| Collateralized mortgage obligations | 129,331           | 674                          | 885                           | 129,120       |
| Total                               | \$418,073         | \$ 3,846                     | \$ 2,635                      | \$419,284     |
| As of December 31, 2016             |                   |                              |                               |               |
|                                     | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
| (Dollars in thousands)              |                   |                              |                               |               |
| Corporate bonds                     | \$25,254          | \$ 6                         | \$ 377                        | \$24,883      |
| Municipal securities                | 157,261           | 901                          | 4,511                         | 153,651       |
| Mortgage-backed securities          | 89,748            | 318                          | 1,898                         | 88,168        |
| Collateralized mortgage obligations | 77,290            | 275                          | 1,187                         | 76,378        |
| Total                               | \$349,553         | \$ 1,500                     | \$ 7,973                      | \$343,080     |

We do not hold any Fannie Mae or Freddie Mac preferred stock, collateralized debt obligations, structured investment vehicles or second lien elements in our investment portfolio. As of September 30, 2017 and December 31, 2016, our investment portfolio did not contain any securities that are directly backed by subprime or Alt-A mortgages. The Bank owns no non-U.S. agency mortgage-backed securities and only one non-U.S. agency corporate collateralized mortgage obligation, which is categorized as held to maturity and had a \$1.5 million carrying value as of September 30, 2017.

Our management evaluates securities for OTTI at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. In 2013, we recognized OTTI with respect to the non-U.S. agency corporate collateralized mortgage obligation that we hold. As of September 30, 2017, \$461,307 of OTTI was recorded.

The following tables sets forth the amortized cost of held to maturity securities and the fair value of available for sale securities, maturities and approximated weighted average yield based on estimated annual income divided by the average amortized cost of our securities portfolio as of the dates indicated. The contractual maturity of a mortgage-backed security is the date at which the last underlying mortgage matures.

| As of September 30, 2017            |                    |        |  |        |   |        |                 |        |           |        |
|-------------------------------------|--------------------|--------|--|--------|---|--------|-----------------|--------|-----------|--------|
|                                     | Within One<br>Year |        | After One Year<br>but Within Five<br>Years |        | After Five Years<br>but Within Ten<br>Years |        | After Ten Years |        | Total     |        |
|                                     | Amount             | Yield  | Amount                                     | Yield  | Amount                                      | Yield  | Amount          | Yield  | Total     | Yield  |
| (Dollars in thousands)              |                    |        |  |        |   |        |                 |        |           |        |
| Corporate bonds                     | \$—                | — %    | \$1,096                                    | 2.59 % | \$17,924                                    | 2.93 % | \$—             | — %    | \$19,020  | 2.91 % |
| Municipal securities                | 2,683              | 2.27 % | 5,126                                      | 3.56 % | 43,228                                      | 3.63 % | 103,420         | 3.63 % | \$154,457 | 3.60 % |
| Mortgage-backed securities          | —                  | — %    | 58,496                                     | 2.25 % | 55,799                                      | 2.54 % | —               | — %    | \$114,295 | 2.39 % |
| Collateralized mortgage obligations | 381                | — %    | 84,374                                     | 2.55 % | 44,687                                      | 2.67 % | —               | 2.69 % | \$129,442 | 2.61 % |
| Total                               | \$3,064            | 2.27 % | \$149,092                                  | 2.46 % | \$161,638                                   | 2.89 % | \$103,420       | 3.48 % | \$417,214 | 2.92 % |

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| As of December 31, 2016             |                 |        |                                      |        |                                       |        |                 |        |           |        |
|-------------------------------------|-----------------|--------|--------------------------------------|--------|---------------------------------------|--------|-----------------|--------|-----------|--------|
|                                     | Within One Year |        | After One Year but Within Five Years |        | After Five Years but Within Ten Years |        | After Ten Years |        | Total     |        |
|                                     | Amount          | Yield  | Amount                               | Yield  | Amount                                | Yield  | Amount          | Yield  | Total     | Yield  |
| (Dollars in thousands)              |                 |        |                                      |        |                                       |        |                 |        |           |        |
| Corporate bonds                     | \$—             | — %    | \$7,453                              | 2.30 % | \$17,430                              | 2.93 % | \$—             | — %    | \$24,883  | 2.75 % |
| Municipal securities                | 732             | 3.98 % | 6,103                                | 3.45 % | 38,634                                | 3.49 % | 111,170         | 3.62 % | \$156,639 | 3.58 % |
| Mortgage-backed securities          | —               | — %    | 74,047                               | 2.02 % | 14,093                                | 2.27 % | —               | — %    | \$88,140  | 2.06 % |
| Collateralized mortgage obligations | —               | — %    | 27,668                               | 2.92 % | 26,184                                | 2.68 % | 22,782          | 2.98 % | \$76,634  | 2.81 % |
| Total                               | \$732           | 3.98 % | \$115,271                            | 2.33 % | \$96,341                              | 3.00 % | \$133,952       | 3.50 % | \$346,296 | 2.97 % |

The contractual maturity of mortgage-backed securities and collateralized mortgage obligations is not a reliable indicator of their expected life because borrowers have the right to prepay their obligations at any time.

Mortgage-backed securities and collateralized mortgage obligations are typically issued with stated principal amounts and are backed by pools of mortgage loans and other loans with varying maturities. The term of the underlying mortgages and loans may vary significantly due to the ability of a borrower to prepay. Monthly pay downs on mortgage-backed securities typically cause the average life of the securities to be much different than the stated contractual maturity. During a period of increasing interest rates, fixed rate mortgage-backed securities do not tend to experience heavy prepayments of principal, and, consequently, the average life of this security is typically lengthened. If interest rates begin to fall, prepayments may increase, thereby shortening the estimated life of this security. The weighted average life of our investment portfolio was 7.42 years with an estimated effective duration of 4.63 years as of September 30, 2017.

As of September 30, 2017 and December 31, 2016, respectively, we 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 the consolidated shareholders' equity.

The average yield of our securities portfolio was 2.92% as of September 30, 2017 compared to 2.97% as of December 31, 2016. The decrease in average yield as of September 30, 2017, compared to December 31, 2016, was primarily due to purchases of new mortgage-backed securities and collateralized mortgage obligations, which typically have a lower yield than do the municipal securities in our portfolio. Municipal securities decreased slightly from \$156.6 million at a yield of 3.58%, as of December 31, 2016, to \$154.5 million at a yield of 3.60% as of September 30, 2017, however, municipal securities represent only 37.0% of the total investment portfolio as of September 30, 2017, compared to 45.2% of the total investment portfolio as of December 31, 2016.

#### Deposits

We offer a variety of deposit products, which have a wide range of interest rates and terms, including demand, savings, money market and time accounts. We rely primarily on competitive pricing policies, convenient locations and personalized service to attract and retain these deposits.

Total deposits as of September 30, 2017 were \$1.62 billion, an increase of \$40.5 million, or 2.6%, compared to \$1.58 billion as of December 31, 2016.

The following table presents the average balances on deposits for the periods indicated:

|  | For the<br>Nine<br>Months<br>Ended<br>September<br>30, 2017 | For the<br>Year<br>Ended<br>December<br>31, 2016 | Dollar<br>Change | Percent<br>Change |
|--|---|--|------------------|-------------------|
| (Dollars in thousands)                   |   |  |                  |                   |
| Now and interest-bearing demand accounts | \$264,502   | \$278,521  | \$(14,019)       | (5.03)%           |
| Savings accounts                         | 64,705  | 59,961   | 4,744            | 7.91%             |
| Money market accounts                    | 589,763   | 482,089  | 107,674          | 22.33%            |
| Certificates and other time deposits     | 324,566   | 354,949  | (30,383)         | (8.56)%           |
| Total interest-bearing deposits          | 1,243,536   | 1,175,520  | 68,016           | 5.79%             |
| Noninterest-bearing demand accounts      | 375,655   | 340,240  | 35,415           | 10.41%            |
| Total deposits                           | \$1,619,191   | \$1,515,760                                      | \$103,431        | 6.82%             |

The aggregate amount of time deposits in denominations of \$100,000 or more as of September 30, 2017 and December 31, 2016 was \$190.4 million and \$218.6 million, respectively.

The scheduled maturities of time deposits greater than \$100,000 were as follows:

|                        | As of<br>September 30, 2017 | Weighted<br>Average<br>Interest<br>Rate |  |
|------------------------|-----------------------------|---|--|
| (Dollars in thousands) |                             |   |  |
| Under 3 months         | \$41,718                    | 0.95%                                   |  |
| 3 to 6 months          | 42,231                      | 1.02%                                   |  |
| 6 to 12 months         | 61,233                      | 1.04%                                   |  |
| 12 to 24 months        | 24,091                      | 1.24%                                   |  |
| 24 to 36 months        | 4,574                       | 1.49%                                   |  |
| 36 to 48 months        | 11,936                      | 1.56%                                   |  |
| Over 48 months         | 4,638                       | 1.63%                                   |  |
| Total                  | \$190,421                   | 1.10%                                   |  |

#### Borrowings

We utilize short-term and long-term borrowings to supplement deposits to fund our lending and investment activities, each of which is discussed below.

**Federal Home Loan Bank (FHLB) Advances.** The FHLB allows us to borrow on a blanket floating lien status collateralized by certain securities and loans. As of September 30, 2017 and December 31, 2016, total borrowing capacity of \$471.4 million and \$400.4 million, respectively, was available under this arrangement. Our outstanding FHLB advances mature within 5 years. As of September 30, 2017, approximately \$1.0 billion in real estate loans were pledged as collateral for our FHLB borrowings. We utilize these borrowings to meet liquidity needs and to fund certain fixed rate loans in our portfolio. The following table presents our FHLB borrowings by maturity and weighted average rate as of September 30, 2017:

| Balance | Weighted<br>Average |
|---------|---------------------|
|---------|---------------------|



|                               | Rate                   |      |   |
|-------------------------------|------------------------|------|---|
|                               | (Dollars in thousands) |      |   |
| Less than 90 days             | \$20,000               | 1.17 | % |
| 90 days to less than one year | 25,000                 | 1.12 | % |
| Three to five years           | 20,157                 | 1.11 | % |
| Total                         | \$65,157               | 1.13 | % |

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Federal Reserve Bank of Dallas. The Federal Reserve Bank of Dallas has an available borrower in custody arrangement, which allows us to borrow on a collateralized basis. Certain commercial and industrial and consumer loans are pledged under this arrangement. We maintain this borrowing arrangement to meet liquidity needs pursuant to our contingency funding plan. As of September 30, 2017 and December 31, 2016, \$142.0 million and \$168.3 million, respectively, were available under this arrangement. As of September 30, 2017, approximately \$184.4 million in consumer and commercial and industrial loans were pledged as collateral. As of September 30, 2017 and December 31, 2016, no borrowings were outstanding under this arrangement.

Trust Preferred Securities and Other Debentures. We have issued subordinated debentures relating to the issuance of trust preferred securities. In October 2002, we formed Guaranty (TX) Capital Trust II, which issued \$3.0 million in trust preferred securities to a third party in a private placement. Concurrent with the issuance of the trust preferred securities, the trust issued common securities to the Company in the aggregate liquidation value of \$93,000. The trust invested the total proceeds from the sale of the trust preferred securities and the common securities in \$3.1 million of the Company's junior subordinated debentures, which will mature on October 30, 2032. In July 2006, we formed Guaranty (TX) Capital Trust III, which issued \$2.0 million in trust preferred securities to a third party in a private placement. Concurrent with the issuance of the trust preferred securities, the trust issued common securities to the Company in the aggregate liquidation value of \$62,000. The trust invested the total proceeds from the sale of the trust preferred securities and the common securities in \$2.1 million of the Company's junior subordinated debentures, which will mature on October 1, 2036. In March 2015, we acquired DCB Trust I, which issued \$5.0 million in trust preferred securities to a third party in a private placement. Concurrent with the issuance of the trust preferred securities, the trust issued common securities to the Company in the aggregate liquidation value of \$155,000. The trust invested the total proceeds from the sale of the trust preferred securities and the common securities in \$5.2 million of the Company's junior subordinated debentures, which will mature on June 15, 2037.

With certain exceptions, the amount of the principal and any accrued and unpaid interest on the debentures are subordinated in right of payment to the prior payment in full of all of our senior indebtedness. The terms of the debentures are such that they qualify as Tier 1 capital under the Federal Reserve's regulatory capital guidelines applicable to bank holding companies. Interest on Trust II Debentures is payable at a variable rate per annum, reset quarterly, equal to 3-month LIBOR plus 3.35%, thereafter. Interest on the Trust III Debentures was payable at a fixed rate per annum equal to 7.43% until October 1, 2016 and is a variable rate per annum, reset quarterly, equal to 3-month LIBOR plus 1.67%, thereafter. Interest on the DCB Trust I Debentures is payable at a variable rate per annum, reset quarterly, equal to 3-month LIBOR plus 1.80%. The interest is deferrable on a cumulative basis for up to five consecutive years following a suspension of dividend payments on all other capital stock. No principal payments are due until maturity for each of the debentures.

On any interest payment date on or after (1) June 15, 2012 for the DCB Trust I Debentures, (2) October 30, 2012 for the Trust II Debentures and (3) October 1, 2016 for the Trust III Debentures, and before their respective maturity dates, the debentures are redeemable, in whole or in part, for cash at our option on at least 30, but not more than 60, days' notice at a redemption price equal to 100% of the principal amount to be redeemed, plus accrued interest to the date of redemption.

Beginning in July 2015, we have from time to time issued subordinated debentures. All of the debentures pay interest semi-annually and are redeemable before their maturity date at our option, with 30 days' notice to the holder, for a cash amount equal to the principal amount and all accrued interest. In July 2015, we issued \$4.0 million in debentures, of which \$3.0 million were issued to directors and other related parties. The \$3.0 million of debentures to related parties were repaid in May 2017 with a portion of the proceeds of our initial public offering and a \$500,000 par value debenture, which carried a rate of 2.5%, matured and was repaid in July 2017. The remaining \$500,000 debenture has a rate of 4.0% and matures in January 2019. In December 2015, we issued \$5.0 million in debentures, of which \$2.5 million were issued to directors and other related parties. In May 2017, \$2.0 million of the \$2.5 million of debentures issued to related parties were repaid with a portion of the proceeds of our initial public offering. The remaining \$3.0 million in debentures were issued in the principal amount of \$500,000 each with rates ranging from 3.00% to 5.00% depending on maturity dates, which range from July 1, 2018 to July 1, 2020.

Other Borrowings. We have historically used a line of credit with a correspondent bank as a source of funding for working capital needs, the payment of dividends when there is a temporary timing difference in cash flows, and repurchases of equity securities. As of December 31, 2016, we had a \$15.0 million revolving line of credit and \$10.0 million amortizing note with our correspondent bank. In March 2017, we renegotiated the loan agreement such that the outstanding balance of our revolving line of credit and amortizing note was converted to a \$25.0 million unsecured

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revolving line of credit. The line of credit bears interest at the prime rate plus 0.50%, with quarterly interest payments, and matures in March 2018. During the second quarter of 2017, we used a portion of the proceeds from our initial public offering to repay the outstanding balance of the revolving line of credit. Therefore, as of September 30, 2017, there was no outstanding balance on the line of credit.

#### 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. For the nine months ended September 30, 2017 and the year ended December 31, 2016, liquidity needs were primarily met by core deposits, security and loan maturities and amortizing investment and loan portfolios. Although access to purchased funds from correspondent banks and overnight advances from the FHLB and the Federal Reserve Bank of Dallas are available and have been utilized on occasion to take advantage of investment opportunities, we do not generally rely on these external funding sources. As of September 30, 2017 and December 31, 2016, we maintained three federal funds lines of credit with commercial banks that provide for the availability to borrow up to an aggregate \$70 million in federal funds. There were no funds under these lines of credit outstanding as of September 30, 2017 and December 31, 2016. In addition to these federal funds lines of credit, our \$25.0 million revolving line of credit discussed above provides an additional source of liquidity. The following table illustrates, during the periods presented, the composition of our funding sources and the average assets in which those funds are invested as a percentage of average total assets for the period indicated. Average assets were \$1.9 billion for the nine months ended September 30, 2017 and \$1.8 billion for the year ended December 31, 2016.

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|  | For the Nine<br>Months<br>Ended<br>September 30,<br>2017 |   | For the Year<br>Ended<br>December 31,<br>2016 |   |
|--|--|---|---|---|
| Sources of Funds:  |  |   |   |   |
| Deposits:  |  |   |   |   |
| Noninterest-bearing                                      | 19.95  | % | 19.15   | % |
| Interest-bearing   | 66.03  | % | 66.16   | % |
| Federal funds purchased                                  | —  | % | 0.01  | % |
| Advances from FHLB                                       | 2.21   | % | 3.53  | % |
| Other debt   | 0.48   | % | 0.74  | % |
| Subordinated denentures                                  | 0.88   | % | 1.14  | % |
| Securities sold under agreements to repurchase           | 0.69   | % | 0.73  | % |
| Accrued interest and other liabilities                   | 0.34   | % | 0.36  | % |
| Shareholders' equity                                     | 9.42   | % | 8.18  | % |
| Total  | 100.00   | % | 100.00  | % |
| Uses of Funds:   |  |   |   |   |
| Loans  | 66.76  | % | 65.80   | % |
| Securities available for sale                            | 11.52  | % | 11.17   | % |
| Securities held to maturity                              | 9.78   | % | 10.29   | % |
| Nonmarketable equity securities                          | 0.37   | % | 0.48  | % |
| Federal funds sold                                       | 2.61   | % | 2.96  | % |
| Interest-bearing deposits in other banks                 | 1.26   | % | 1.44  | % |
| Other noninterest-earning assets                         | 7.70   | % | 7.86  | % |
| Total  | 100.00   | % | 100.00  | % |
| Average noninterest-bearing deposits to average deposits | 23.20  | % | 22.45   | % |
| Average loans to average deposits                        | 78.40  | % | 77.84   | % |

Our primary source of funds is deposits, and our primary use of funds is loans. We do not expect a change in the primary source or use of our funds in the foreseeable future. Our average loans, including average loans held for sale, increased \$110.6 million, or 9.5%, for the nine months ended September 30, 2017 compared to the same period in 2016. We predominantly invest excess deposits in overnight deposits with our correspondent banks, federal funds sold, securities, interest-bearing deposits at other banks or other short-term liquid investments until needed to fund loan growth.

As of September 30, 2017, we had \$339.9 million in outstanding commitments to extend credit and \$9.3 million in commitments associated with outstanding standby and commercial letters of credit. As of December 31, 2016, we had \$297.6 million in outstanding commitments to extend credit and \$8.9 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, 2017 and December 31, 2016, we had no exposure to future cash requirements associated with known uncertainties or capital expenditures of a material nature, except for the put option associated with shares distributed from our KSOP, which terminated upon consummation of our initial public offering and listing on the NASDAQ Global Select Market in May 2017. As of September 30, 2017, we had cash and cash equivalents of \$95.1 million, compared to \$127.5 million as of December 31, 2016. The decrease was primarily due to a decrease in federal funds sold of \$26.4 million.

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### Capital Resources

Total shareholders' equity increased to \$207.3 million as of September 30, 2017, compared to \$141.9 million as of December 31, 2016 (including KSOP-owned shares), an increase of \$65.3 million, or 46.0%. The increase from December 31, 2016 was primarily the result of the issuance of new shares of common stock in connection with our initial public offering in May 2017, as well as \$11.6 million in net earnings for the nine months ended September 30, 2017 and the decrease in accumulated other comprehensive loss of \$1.6 million, related primarily to increased value in the unrealized gains on securities held for sale and partially offset by the payment of dividends of \$4.0 million. Capital management consists of providing equity and other instruments that qualify as regulatory capital to support current and future operations. Banking regulators view capital levels as important indicators of an institution's financial soundness. 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. We are subject to certain regulatory capital requirements at the bank holding company and bank levels. As of September 30, 2017 and December 31, 2016, we were in compliance with all applicable regulatory capital requirements at the bank and bank holding company levels, and the Bank was classified as "well capitalized," for purposes of the prompt corrective action regulations. As we deploy our capital and continue to grow our operations, our regulatory capital levels may decrease depending on our level of earnings. However, we expect to monitor and control our growth in order to remain in compliance with all regulatory capital standards applicable to us.

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The following table presents our regulatory capital ratios as of:

|  | September 30,<br>2017 |        | December 31,<br>2016 |        |
|--|-----------------------|--------|----------------------|--------|
|  | Amount                | Ratio  | Amount               | Ratio  |
| (Dollars in thousands)                   |                       |        |                      |        |
| Guaranty Bancshares, Inc.                |                       |        |                      |        |
| Total capital (to risk weighted assets)  | \$213,905             | 14.62% | \$149,468            | 10.86% |
| Tier 1 capital (to risk weighted assets) | 201,377               | 13.76% | 137,984              | 10.03% |
| Tier 1 capital (to average assets)       | 201,377               | 10.68% | 137,984              | 7.71%  |
| Common equity tier 1 risk-based capital  | 191,067               | 13.06% | 127,674              | 9.28%  |

#### Guaranty Bank & Trust

|  |           |        |           |        |
|--|-----------|--------|-----------|--------|
| Total capital (to risk weighted assets)  | \$202,722 | 13.85% | \$173,528 | 12.63% |
| Tier 1 capital (to risk weighted assets) | 190,194   | 13.00% | 162,044   | 11.79% |
| Tier 1 capital (to average assets)       | 190,194   | 10.08% | 162,044   | 9.06%  |
| Common equity tier 1 risk-based capital  | 190,195   | 13.00% | 162,044   | 11.79% |

#### Contractual Obligations

The following table summarizes contractual obligations and other commitments to make future payments as of September 30, 2017 (other than non-time deposit obligations), which consist of future cash payments associated with our contractual obligations.

|                         | As of September 30, 2017 |  |                                       |                 |           |
|-------------------------|--------------------------|--|---------------------------------------|-----------------|-----------|
|                         | 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     |
| (Dollars in thousands)  |                          |  |                                       |                 |           |
| Time deposits           | \$232,964                | \$46,392                               | \$23,726                              | \$—             | \$303,082 |
| Advances from FHLB      | 45,000                   | —                                      | 20,157                                | —               | 65,157    |
| Subordinated debentures | 1,000                    | 2,500                                  | —                                     | 10,310          | 13,810    |
| Total                   | \$278,964                | \$48,892                               | \$43,883                              | \$10,310        | \$382,049 |

#### Off-Balance Sheet Items

In the normal course of business, we enter into various transactions, which, in accordance with GAAP, are not included in our consolidated balance sheets. We enter into these transactions to meet the financing needs of our customers. 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.

Our 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. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements.



|  | As of September 30, 2017 |  |                                       |                 |           |
|--|--------------------------|--|---------------------------------------|-----------------|-----------|
|  | 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     |
|  | (Dollars in thousands)   |  |                                       |                 |           |
| Standby and commercial letters of credit | \$7,465                  | \$ 212                                 | \$ 91                                 | \$1,566         | \$9,334   |
| Commitments to extend credit             | 154,305                  | 45,252                                 | 74,833                                | 65,482          | 339,872   |
| Total                                    | \$161,770                | \$ 45,464                              | \$ 74,924                             | \$67,048        | \$349,206 |

Standby and commercial letters of credit are conditional commitments issued by us to guarantee the performance of a customer to a third party. In the event of nonperformance by the customer, we have rights to the underlying collateral, which can include commercial real estate, physical plant and property, inventory, receivables, cash and/or marketable securities. Our 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. We evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if considered necessary by us, upon extension of credit, is based on management's credit evaluation of the customer.

#### Interest Rate Sensitivity and Market Risk

As a financial institution, our primary component of market risk is interest rate volatility. Our asset liability and funds management policy provides management with the guidelines for effective funds management, and we have established a measurement system for monitoring our net interest rate sensitivity position. We have historically managed our sensitivity position within our established guidelines.

Fluctuations in interest rates will ultimately impact both the level of income and expense recorded on most of our 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 loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximizing income.

We manage our exposure to interest rates by structuring our balance sheet in the ordinary course of business. We do not enter into instruments such as leveraged derivatives, financial options, financial future contracts or forward delivery contracts for the purpose of reducing interest rate risk. Based upon the nature of our operations, we are not subject to foreign exchange or commodity price risk. We do not own any trading assets.

Our exposure to interest rate risk is managed by the asset-liability committee of the Bank, in accordance with policies approved by its 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 on 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.

We use 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

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standard regulatory decay assumptions and are incorporated into the model. The assumptions used 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 management strategies.

On a quarterly basis, we run two simulation models 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 twelve-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. Our 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 15.0% for a 100 basis point shift, 20.0% for a 200 basis point shift and 30.0% for a 300 basis point shift. The following table summarizes the simulated change in net interest income and fair value of equity over a 12-month horizon as of:

| Change in Interest Rates (Basis Points) | September 30, 2017                    |  | December 31, 2016                     |  |
|---|---------------------------------------|--|---------------------------------------|--|
|   | 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                                    | 1.83                                  | % (15.87%)                             | 1.44                                  | % (18.99%)                             |
| +200                                    | 1.92                                  | % (7.71%)                              | 1.42                                  | % (9.58%)                              |
| +100                                    | 1.71                                  | % (2.41%)                              | 1.19                                  | % (3.45%)                              |
| Base                                    | —                                     | % —                                    | % —                                   | % —                                    |
| -100                                    | (0.54%)                               | (4.72%)                                | (0.29%)                               | (1.80%)                                |

The results are primarily due to behavior of demand, money market and savings deposits during such rate fluctuations. We have found that, historically, interest rates on these deposits change 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.

#### Impact of Inflation

Our consolidated financial statements and related notes included elsewhere in this Report 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 our 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

Our accounting and reporting policies conform to GAAP and the prevailing practices in the banking industry. However, we also evaluate our performance based on certain additional financial measures discussed in this Report as being non-GAAP financial measures. We classify a financial measure as being 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 included or excluded, as the case may be, in the most directly comparable measure calculated and presented in accordance with GAAP as in effect from time to time in the United States in our statements

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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 either financial measures calculated in accordance with GAAP, operating measures or other measures that are not non-GAAP financial measures or both.

The non-GAAP financial measures that we discuss in this Report 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 manner in which we calculate the non-GAAP financial measures that we discuss in this Report may differ from that of other companies reporting measures with similar names. It is important to understand how other banking organizations calculate their financial measures with names similar to the non-GAAP financial measures we have discussed in this Report when comparing such non-GAAP financial measures.

**Tangible Book Value Per Common Share.** Tangible book value per common share is a non-GAAP measure generally used by investors, financial analysts and investment bankers to evaluate financial institutions. We calculate (1) tangible common equity as total shareholders' equity, less goodwill, core deposit intangibles and other intangible assets, net of accumulated amortization, and (2) tangible book value per common share as tangible common equity divided by shares of common stock outstanding. The most directly comparable GAAP financial measure for tangible book value per common share is book value per common share.

We believe that the tangible book value per common share measure is important to many investors in the marketplace who are interested in changes from period to period in book value per common share exclusive of changes in intangible assets. Goodwill and other intangible assets have the effect of increasing total book value while not increasing our tangible book value.

The following table reconciles, as of the dates set forth below, total shareholders' equity to tangible common equity and presents tangible book value per common share compared to book value per common share:

|   | As of September 30,                           |           | As of<br>December<br>31,<br>2016 |
|---|---|-----------|----------------------------------|
|   | 2017  | 2016      | 2016                             |
|   | (Dollars in thousands, except per share data) |           |                                  |
| <b>Tangible Common Equity</b>                           |   |           |                                  |
| Total shareholders' equity, including KSOP-owned shares | \$207,263                                     | \$148,005 | \$141,914                        |
| Adjustments:  |   |           |                                  |
| Goodwill  | (18,742 )                                     | (18,742 ) | (18,742 )                        |
| Core deposit and other intangibles                      | (2,870 )                                      | (3,453 )  | (3,308 )                         |
| Total tangible common equity                            | \$185,651                                     | \$125,810 | \$119,864                        |
| Common shares outstanding <sup>(1)</sup>                | 11,058,956                                    | 8,955,476 | 8,751,923                        |
| Book value per common share                             | \$18.74                                       | \$16.53   | \$16.22                          |
| Tangible book value per common share                    | \$16.79                                       | \$14.05   | \$13.70                          |

(1) Excludes the dilutive effect, if any, of 75,505, 9,581 and 8,066 shares of common stock issuable upon exercise of outstanding stock options as of September 30, 2017, September 30, 2016 and December 31, 2016, respectively.

**Tangible Common Equity to Tangible Assets.** Tangible common equity to tangible assets is a non-GAAP measure generally used by investors, financial analysts and investment bankers to evaluate financial institutions. We calculate tangible common equity, as described above, and tangible assets as total assets less goodwill, core deposit intangibles and other intangible assets, net of accumulated amortization. The most directly comparable GAAP financial measure for tangible common equity to tangible assets is total common shareholders' equity to total assets.

We believe that this measure is important to many investors in the marketplace who are interested in the relative changes from period to period of tangible common equity to tangible assets, each exclusive of changes in intangible assets. Goodwill and other intangible assets have the effect of increasing both total shareholders' equity and assets while not increasing our tangible common equity or tangible assets.

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The following table reconciles, as of the dates set forth below, total shareholders' equity to tangible common equity and total assets to tangible assets:

|   | As of<br>September 30,<br>2017 | As of<br>December 31,<br>2016 |
|---|--------------------------------|-------------------------------|
|   | (Dollars in thousands)         |                               |
| <b>Tangible Common Equity</b>                           |                                |                               |
| Total shareholders' equity, including KSOP-owned shares | \$207,263                      | \$ 141,914                    |
| <b>Adjustments:</b>                                     |                                |                               |
| Goodwill  | (18,742 )                      | (18,742 )                     |
| Core deposit and other intangibles                      | (2,870 )                       | (3,308 )                      |
| Total tangible common equity                            | \$ 185,651                     | \$ 119,864                    |
| <b>Tangible Assets</b>                                  |                                |                               |
| Total assets  | \$ 1,924,053                   | \$ 1,828,336                  |
| <b>Adjustments:</b>                                     |                                |                               |
| Goodwill  | (18,742 )                      | (18,742 )                     |
| Core deposit and other intangibles                      | \$(2,870 )                     | \$(3,308 )                    |
| Total tangible assets                                   | \$ 1,902,441                   | \$ 1,806,286                  |

#### Cautionary Notice Regarding Forward-Looking Statements

This Report, our other filings with the SEC, and other press releases, documents, reports and announcements that we make, issue or publish may contain statements that we believe are "forward-looking statements" within the meaning of section 27A of the Securities Act and section 21E of the Exchange Act. These forward-looking statements reflect our current views with respect to, among other things, future events and our financial performance, including our future revenues, income, expenses, provision for taxes, effective tax rate, earnings per share and cash flows, our future capital expenditures and dividends, our future financial condition and changes therein, including changes in our loan portfolio and allowance for loan losses, our future capital structure or changes therein, the plan and objectives of management for future operations, our future or proposes acquisitions, the future or expected effect of acquisitions on our operations, results of the operations and financial condition, our future economic performance and the statements of the assumptions underlying any such statement. 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," "anticipate," "seek," "estimate," "intend," "plan," "projection," "would" and "outlook," or the negative version of those words or 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 following:

- our ability to prudently manage our growth and execute our strategy;
- risks associated with our acquisition and de novo branching strategy;
- business and economic conditions generally and in the financial services industry, nationally and within our primary Texas markets;
- concentration of our business within our geographic areas of operation in Texas;
- deterioration of our asset quality and higher loan charge-offs;
- changes in the value of collateral securing our loans;
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inaccuracies in the assumptions and estimate we make in establishing the allowance for loan losses reserve and other estimates;

• changes in management personnel and our ability to attract, motivate and retain qualified personnel;

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liquidity risks associated with our business;

interest rate risk associated with our business that could decrease net interest income;

our ability to maintain important deposit customer relationships and our reputation;

operational risks associated with our business;

volatility and direction of market interest rates;

change in regulatory requirements to maintain minimum capital levels;

increased competition in the financial services industry, particularly from regional and national institutions;

institution and outcome of litigation and other legal proceeding against us or to which we become subject;

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;

changes in the scope and cost of FDIC insurance and other coverage;

natural disasters and adverse weather, acts of terrorism (including cyber attacks), an outbreak of hostilities or other international or domestic calamities, catastrophic events including storms, droughts, tornados and flooding, and other matters beyond our control;

risks that the financial institutions we may acquire or de novo branches we may open will not be integrated successfully, or the integrations may be more time consuming or costly than expected;

technology related changes are difficult to make or are more expensive than expected;

the other factors that are described or referenced in our IPO Prospectus under the caption "Risk Factors";

The foregoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included in this Report. 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.

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 we manage 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 (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, 2017 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 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 combined results of operations, financial condition or cash flows. However, one or more unfavorable outcomes in any claim or litigation against the Company 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 adversely affect the Company's reputation, even if resolved in our favor.

### Item 1A. Risk Factors

In evaluating an investment in the Company's common stock, investors should consider carefully, among other things, the risk factors previously disclosed in under the caption "Risk Factors" in the Company's IPO Prospectus filed with the Securities and Exchange Commission on May 9, 2017 pursuant to Rule 424(b) of the Securities Act, in connection with the initial public offering of the Company's common stock. The Company's business could be harmed by any of these risks. The trading price of the Company's common stock could decline due to any of these risks, and you may lose all or part of your investment.

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

There were no sales of equity securities by the Company during the period covered by this Report that were not registered with the SEC under the Securities Act. In May 2017, during the period covered by this Report, the Company issued and sold 2,300,000 shares of our common stock, including 300,000 shares of common stock sold pursuant to the underwriters' full exercise of their option to purchase additional shares, in the Company's initial public offering at an offering price of \$27.00 per share, for aggregate net proceeds of approximately \$57.6 million. All of the shares issued and sold in the initial public offering were registered under the Securities Act pursuant to a Registration Statement on Form S-1 (File No. 333-217176), which was declared effective by the Securities and Exchange Commission on May 8, 2017. Sandler O'Neill + Partners, L.P. and Stephens Inc. acted as underwriters. There has been no material change in the planned use of proceeds from our initial public offering as described in our IPO Prospectus (File No. 333-217176), filed with the Securities and Exchange Commission on May 9, 2017 pursuant to Rule 424(b) of the Securities Act.

### Item 3. Defaults Upon Senior Securities

None.

### Item 4. Mine Safety Disclosures

Not applicable.

### Item 5. Other Information

None.

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Item 6. Exhibits

| Exhibit<br>Number | Description of Exhibit  |
|-------------------|---|
| <u>3.1</u>        | Amended and Restated Certificate of Formation of Guaranty Bancshares, Inc. (incorporated by reference to Exhibit 3.1 to Amendment No. 1 to the Company's Registration Statement on Form S-1 filed May 1, 2017 (File No. 333-217176)).   |
| <u>3.2</u>        | Amended and Restated Bylaws of Guaranty Bancshares, Inc. (incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 filed April 6, 2017 (File No. 333-217176)).  |
| <u>31.1</u> *     | Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| <u>31.2</u> *     | Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| <u>32.1</u> **    | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |
| <u>32.2</u> **    | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |
| 101*              | The following materials from Guaranty Bancshares' Quarterly Report on Form 10-Q for the quarter ended September 30, 2017, formatted in XBRL (Extensible Business Reporting Language), furnished herewith: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Comprehensive Income (Loss), (iv) Consolidated Statements of Changes in Shareholders' Equity, (v) Consolidated Statements of Cash Flows, and (vi) Notes to 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.

GUARANTY BANCSHARES, INC.  
(Registrant)

Date: November 13, 2017 /s/ Tyson T. Abston  
Tyson T. Abston  
Chairman of the Board & Chief Executive Officer

Date: November 13, 2017 /s/ Clifton A. Payne  
Clifton A. Payne  
Chief Financial Officer & Director

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