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 (Do not check if a smaller reporting company)	Smaller reporting company
	Emerging growth company

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

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

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

GUARANTY BANCSHARES, INC.

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
GUARANTY BANCSHARES, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except share amounts)

	(Unaudited) September 30, 2017	(Audited) December 31, 2016
ASSETS		
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
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits		
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
Commitments and contingent liabilities		
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) September 30, 2017	(Audited) December 31, 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 Ended September 30,		Nine Months Ended September 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 Ended September 30,		Nine Months Ended September 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 STATMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)
(Dollars in thousands, except share amounts)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Less: KSOP-Owned Shares	Total Shareholders' 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 Months Ended 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 Ended September 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

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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 pubic 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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(Dollars in thousands, except per share data)

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 Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair 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

(Continued)

(Dollars in thousands, except per share data)

December 31, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair 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	
September 30, 2017	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value
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

	Less Than 12 Months		12 Months or Longer		Total	
December 31, 2016	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value
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 Ended September 30,		Nine Months Ended 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 Months Ended September 30,		Nine Months Ended 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 Cost	Estimated Fair Value	Amortized Cost	Estimated Fair 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, 2017	December 31, 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 ended September 30, 2017	Commercial and industrial	Construction and development	Commercial real estate	Farmland	1-4 family residential	Multi-family residential	Consumer	Agricultural	Overdrafts	Total
Allowance for loan losses:										
Beginning balance	$1,592	$1,161	$3,264	$482	$3,960	$281	$585	$153	$6	$11,484
Provision for loan losses	602	762	1,019	(24)	(585)	(15)	149	258	84	2,250
Loans charged-off	(737)	—	(84)	—	(307)	—	(230)	(4)	(117)	(1,479)
Recoveries	116	—	—	—	21	—	95	—	41	273
Ending balance	$1,573	$1,923	$4,199	$458	$3,089	$266	$599	$407	$14	$12,528
Allowance ending balance:										
Individually evaluated for impairment	$19	$—	$31	$85	$145	$—	$—	$240	$—	$520
Collectively evaluated for impairment	1,554	1,923	4,168	373	2,944	266	599	167	14	12,008
Ending balance	$1,573	$1,923	$4,199	$458	$3,089	$266	$599	$407	$14	$12,528
Loans:										
Individually evaluated for impairment	$354	$—	$4,029	$276	$1,097	$228	$—	$696	$—	$6,680
Collectively evaluated for impairment	192,309	201,067	389,285	54,073	364,792	23,007	51,711	23,753	698	1,300,695
Ending balance	$192,663	$201,067	$393,314	$54,349	$365,889	$23,235	$51,711	$24,449	$698	$1,307,375

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	Agricultural	Overdrafts	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 months ended September 30, 2016	Commercial and industrial	Construction and development	Commercial real estate	Farmland	1-4 family residential	Multi-family residential	Consumer	Agricultural	Overdrafts	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	949	134	993	74	916	46	74	(10)	64	3,240
Loans charged-off	(1,196)	(9)	—	—	(25)	—	(170)	—	(119)	(1,519)
Recoveries	14	4	—	—	—	—	103	—	61	182
Ending balance	$1,645	$1,133	$3,099	$474	$3,730	$371	$569	$128	$17	$11,166
Allowance ending balance:										
Individually evaluated for impairment	$139	$—	$—	$47	$82	$—	$29	$1	$—	$298
Collectively evaluated for impairment	1,506	1,133	3,099	427	3,648	371	540	127	17	10,868
Ending balance	$1,645	$1,133	$3,099	$474	$3,730	$371	$569	$128	$17	$11,166
Loans:										
Individually evaluated for impairment	$236	$—	$1,464	$259	$2,177	$—	$208	$319	$—	$4,663
Collectively evaluated for impairment	224,381	125,045	359,212	61,643	346,224	34,538	54,137	18,904	594	1,224,678
Ending 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, 2017	Commercial and industrial	Construction and development	Commercial real estate	Farmland	1-4 family residential	Multi-family residential	Consumer and 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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December 31, 2016	Commercial and industrial	Construction and development	Commercial real estate	Farmland	1-4 family residential	Multi-family residential	Consumer and 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 Days Past Due	60 to 89 Days Past Due	90 Days and Greater Past Due	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and 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 Days Past Due	60 to 89 Days Past Due	90 Days and Greater Past Due	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and 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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The following table presents information regarding nonaccrual loans as of:

	September 30, 2017	December 31, 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, 2017	December 31, 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:

Nine Months Ended September 30, 2017	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded 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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Nine Months Ended September 30, 2016	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded 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 Principal Balance	Recorded Investment	Related Allowance	Average Recorded 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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The following table presents information about the Company's impaired loans as of:

December 31, 2016	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded 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, 2017	December 31, 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, 2002	July 25, 2006	March 29, 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 Debentures	Trust III Debentures	DCB Trust I Debentures
Original amount	$ 3,093	$ 2,062	$ 5,155
Maturity date	October 30, 2032	October 1, 2036	June 15, 2037
Interest due	Quarterly	Quarterly	Quarterly

(Continued)

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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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 Contractual Life in Years	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 Contractual Life in Years	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

(Continued)

(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 Remaining Contractual Life in Years	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 Remaining Contractual Life in Years	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 Ended September 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 Amount	Pay Rate	Receive Rate	Effective Date	Maturity in Years	Unrealized 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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(Dollars in thousands, except per share data)

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 Amount	
	September 30, 2017	December 31, 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.

(Continued)

(Dollars in thousands, except per share data)

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 %

	Actual		Minimum Required For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
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” (“CETI”), (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 Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (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	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
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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(Dollars in thousands, except per share data)

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

	September 30, 2017	December 31, 2016	September 30, 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 Technique(s)	Unobservable Input(s)	Range (Weighted Average)
September 30, 2017				
Impaired loans	$ 6,160	Fair value of collateral - sales comparison approach	Selling costs or other normal adjustments: Real estate Equipment	10%-20% (16%) 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 Technique(s)	Unobservable Input(s)	Range (Weighted Average)
December 31, 2016				
Impaired loans	$ 6,065	Fair value of collateral - sales comparison approach	Selling costs or other normal adjustments: Real estate Equipment	10%-20% (16%) 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 September 30, 2017 using:				
	Carrying Amount	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total 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 December 31, 2016 using:				
	Carrying Amount	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total 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).

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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.

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(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 Ended September 30,		Nine Months Ended September 30,	
	2017	2016	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)	11,058,950	8,955,476	9,951,767	8,991,671
Effect of dilutive securities:				
Common stock equivalent shares from stock options	105,473	9,581	75,505	9,581
Weighted-average shares outstanding (diluted)	11,164,423	8,965,057	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)

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 otherwises, 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. 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 refers 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 Ended September 30,			
	2017		2016	
	(Dollars in thousands, except 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(1)	3.37	%	3.25	%
Net interest rate spread(2)	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 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[1]	$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		
Liabilities and Stockholders' Equity						
Interest-bearing liabilities:						
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 %
Noninterest-bearing liabilities:						
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[2]						