

ServisFirst Bancshares, Inc.
Form 10-Q
April 30, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2019

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 001-36452

SERVISFIRST BANCSHARES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

26-0734029

*(State or Other Jurisdiction of (I.R.S. Employer
Incorporation or Organization) Identification No.)*

2500 Woodcrest Place, Birmingham, Alabama 35209

(Address of Principal Executive Offices) (Zip Code)

(205) 949-0302

(Registrant's Telephone Number, Including Area Code)

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

| <u>Title of each class</u> | <u>Trading symbol(s)</u> | <u>Name of each exchange on which registered</u> |
|--|--------------------------|--|
| Common stock, par value \$.001 per share | SFBS | The NASDAQ Stock Market LLC |

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

None

(Title of Class)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T 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 small reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "non-accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act (Check one):

Edgar Filing: ServisFirst Bancshares, Inc. - Form 10-Q

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company

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

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

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

| <u>Class</u> | <u>Outstanding as of April 26, 2019</u> |
|--------------------------------|---|
| Common stock, \$.001 par value | 53,511,182 |

TABLE OF CONTENTS

| | |
|--|------------------|
| <u>PART I. FINANCIAL INFORMATION</u> | <u>3</u> |
| Item 1. <u>Consolidated Financial Statements</u> | <u>3</u> |
| Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u> | <u>22</u> |
| Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u> | <u>35</u> |
| Item 4. <u>Controls and Procedures</u> | <u>35</u> |
| <u>PART II. OTHER INFORMATION</u> | <u>36</u> |
| Item 1. <u>Legal Proceedings</u> | <u>36</u> |
| Item 1A. <u>Risk Factors</u> | <u>36</u> |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | <u>36</u> |
| Item 3. <u>Defaults Upon Senior Securities</u> | <u>36</u> |
| Item 4. <u>Mine Safety Disclosures</u> | <u>36</u> |
| Item 5. <u>Other Information</u> | <u>36</u> |
| Item 6. <u>Exhibits</u> | <u>36</u> |
| <u>10.1 Third Amendment to the ServisFirst Bancshares, Inc. Amended and Restated 2009 Stock Incentive Plan</u> | |
| <u>10.2 Form of Nonqualified Stock Option Award Pursuant to the ServisFirst Bancshares, Inc. Amended and Restated 2009 Stock Incentive Plan (Revised 2019)</u> | |
| <u>10.3 Form of ServisFirst Bancshares, Inc. Amended and Restated 2009 Stock Incentive Plan Restricted Stock Award Agreement (Revised 2019)</u> | |
| <u>EX-31.01 SECTION 302 CERTIFICATION OF THE CEO</u> | |
| <u>EX-31.02 SECTION 302 CERTIFICATION OF THE CFO</u> | |
| <u>EX-32.01 SECTION 906 CERTIFICATION OF THE CEO</u> | |
| <u>EX-32.02 SECTION 906 CERTIFICATION OF THE CFO</u> | |

PART 1. FINANCIAL INFORMATION**ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS****SERVISFIRST BANCSHARES, INC.****CONSOLIDATED BALANCE SHEETS****(In thousands, except share and per share amounts)**

| | March 31, 2019 (Unaudited) | December 31, 2018 (1) |
|--|----------------------------------|-----------------------------|
| ASSETS | | |
| Cash and due from banks | \$71,058 | \$97,516 |
| Interest-bearing balances due from depository institutions | 547,036 | 360,534 |
| Federal funds sold | 181,435 | 223,845 |
| Cash and cash equivalents | 799,529 | 681,895 |
| Available for sale debt securities, at fair value | 631,696 | 590,184 |
| Held to maturity debt securities (fair value of \$250 at March 31, 2019) | 250 | - |
| Mortgage loans held for sale | 1,223 | 120 |
| Loans | 6,659,908 | 6,533,499 |
| Less allowance for loan losses | (70,207) | (68,600) |
| Loans, net | 6,589,701 | 6,464,899 |
| Premises and equipment, net | 57,664 | 57,822 |
| Accrued interest and dividends receivable | 26,998 | 24,070 |
| Deferred tax assets, net | 26,209 | 27,277 |
| Other real estate owned and repossessed assets | 5,480 | 5,169 |
| Bank owned life insurance contracts | 131,411 | 130,649 |
| Goodwill and other identifiable intangible assets | 14,381 | 14,449 |
| Other assets | 26,294 | 10,848 |
| Total assets | \$8,310,836 | \$8,007,382 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Liabilities: | | |
| Deposits: | | |
| Noninterest-bearing | \$1,572,703 | \$1,557,341 |
| Interest-bearing | 5,510,963 | 5,358,367 |
| Total deposits | 7,083,666 | 6,915,708 |
| Federal funds purchased | 373,378 | 288,725 |
| Other borrowings | 64,675 | 64,666 |
| Accrued interest payable | 11,476 | 10,381 |

Edgar Filing: ServisFirst Bancshares, Inc. - Form 10-Q

| | | |
|---|-------------|-------------|
| Other liabilities | 32,055 | 12,699 |
| Total liabilities | 7,565,250 | 7,292,179 |
| Stockholders' equity: | | |
| Preferred stock, par value \$0.001 per share; 1,000,000 authorized and undesignated at March 31, 2019 and December 31, 2018 | — | — |
| Common stock, par value \$0.001 per share; 100,000,000 shares authorized; 53,495,208 shares issued and outstanding at March 31, 2019, and 53,375,195 shares issued and outstanding at December 31, 2018 | 53 | 53 |
| Additional paid-in capital | 218,147 | 218,521 |
| Retained earnings | 527,853 | 500,868 |
| Accumulated other comprehensive loss | (969) | (4,741) |
| Total stockholders' equity attributable to ServisFirst Bancshares, Inc. | 745,084 | 714,701 |
| Noncontrolling interest | 502 | 502 |
| Total stockholders' equity | 745,586 | 715,203 |
| Total liabilities and stockholders' equity | \$8,310,836 | \$8,007,382 |

(1) Derived from audited financial statements.

See Notes to Consolidated Financial Statements.

SERVISFIRST BANCSHARES, INC.**CONSOLIDATED STATEMENTS OF INCOME****(In thousands, except share and per share amounts)****(Unaudited)**

| | Three Months Ended March 31, | |
|---|---------------------------------|----------|
| | 2019 | 2018 |
| Interest income: | | |
| Interest and fees on loans | \$85,524 | \$69,674 |
| Taxable securities | 3,746 | 2,745 |
| Nontaxable securities | 446 | 656 |
| Federal funds sold | 1,219 | 551 |
| Other interest and dividends | 2,764 | 383 |
| Total interest income | 93,699 | 74,009 |
| Interest expense: | | |
| Deposits | 22,145 | 9,621 |
| Borrowed funds | 2,776 | 1,952 |
| Total interest expense | 24,921 | 11,573 |
| Net interest income | 68,778 | 62,436 |
| Provision for loan losses | 4,885 | 4,139 |
| Net interest income after provision for loan losses | 63,893 | 58,297 |
| Noninterest income: | | |
| Service charges on deposit accounts | 1,702 | 1,585 |
| Mortgage banking | 575 | 518 |
| Credit card income | 1,576 | 1,255 |
| Securities gains (losses) | — | 4 |
| Increase in cash surrender value life insurance | 762 | 777 |
| Other operating income | 327 | 276 |
| Total noninterest income | 4,942 | 4,415 |
| Non-interest expenses: | | |
| Salaries and employee benefits | 14,265 | 13,296 |
| Equipment and occupancy expense | 2,259 | 1,954 |
| Professional services | 994 | 805 |
| FDIC and other regulatory assessments | 1,019 | 1,133 |
| Other real estate owned expense | 22 | 316 |
| Other operating expenses | 6,767 | 5,554 |
| Total non-interest expenses | 25,326 | 23,058 |
| Income before income taxes | 43,509 | 39,654 |
| Provision for income taxes | 8,499 | 7,051 |
| Net income | 35,010 | 32,603 |
| Dividends on preferred stock | — | — |

Edgar Filing: ServisFirst Bancshares, Inc. - Form 10-Q

| | | |
|---|----------|----------|
| Net income available to common stockholders | \$35,010 | \$32,603 |
| Basic earnings per common share | \$0.65 | \$0.61 |
| Diluted earnings per common share | \$0.65 | \$0.60 |

See Notes to Consolidated Financial Statements.

SERVISFIRST BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

| | Three Months Ended March 31, | |
|---|---------------------------------|----------|
| | 2019 | 2018 |
| Net income | \$35,010 | \$32,603 |
| Other comprehensive income (loss), net of tax: | | |
| Unrealized holding gains (losses) arising during period from securities available for sale, net of tax of \$1,002 and \$(1,340) for 2019 and 2018, respectively | 3,772 | (4,910) |
| Reclassification adjustment for net gains on sale of securities, net of tax of \$1 for 2018 | – | 3 |
| Other comprehensive income (loss), net of tax | 3,772 | (4,907) |
| Comprehensive income | \$38,782 | \$27,696 |

See Notes to Consolidated Financial Statements.

SERVISFIRST BANCSHARES, INC.**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY****Three Months Ended March 31, 2019 and 2018****(In thousands, except share amounts)****(Unaudited)**

| | Preferred Stock | Common Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income | Noncontrol Interest | Total Stockholders' Equity |
|---|----------------------------|-------------------------|---|------------------------------|---|--------------------------------|---|
| Balance, January 1, 2018 | \$ — | \$ 53 | \$ 217,693 | \$ 389,554 | \$ (198) | \$ 502 | \$ 607,604 |
| Common dividends declared, \$0.11 per share | — | — | — | (5,846) | — | — | (5,846) |
| Issue 143,833 shares of common stock upon exercise of stock options | — | — | 852 | — | — | — | 852 |
| 30,003 shares of common stock withheld in net settlement upon exercise of stock options | — | — | (1,247) | — | — | — | (1,247) |
| Stock-based compensation expense | — | — | 238 | — | — | — | 238 |
| Other comprehensive income, net of tax | — | — | — | — | (4,907) | — | (4,907) |
| Net income | — | — | — | 32,603 | — | — | 32,603 |
| Balance, March 31, 2018 | \$ — | \$ 53 | \$ 217,536 | \$ 416,311 | \$ (5,105) | \$ 502 | \$ 629,297 |
| Balance, January 1, 2019 | \$ — | \$ 53 | \$ 218,521 | \$ 500,868 | \$ (4,741) | \$ 502 | \$ 715,203 |
| Common dividends declared, \$0.15 per share | — | — | — | (8,025) | — | — | (8,025) |
| Issue 117,313 shares of common stock upon exercise of stock options | — | — | 797 | — | — | — | 797 |
| 45,187 shares of common stock withheld in net settlement upon exercise of stock options | — | — | (1,453) | — | — | — | (1,453) |
| Stock-based compensation expense | — | — | 282 | — | — | — | 282 |
| Other comprehensive loss, net of tax | — | — | — | — | 3,772 | — | 3,772 |
| Net income | — | — | — | 35,010 | — | — | 35,010 |
| Balance, March 31, 2019 | \$ — | \$ 53 | \$ 218,147 | \$ 527,853 | \$ (969) | \$ 502 | \$ 745,586 |

See Notes to Consolidated Financial Statements.

SERVISFIRST BANCSHARES, INC.**CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands) (Unaudited)**

| | Three Months Ended March 31, | |
|---|---------------------------------|-----------|
| | 2019 | 2018 |
| OPERATING ACTIVITIES | | |
| Net income | \$35,010 | \$32,603 |
| Adjustments to reconcile net income to net cash provided by | | |
| Deferred tax expense | 1,068 | 1,554 |
| Provision for loan losses | 4,885 | 4,139 |
| Depreciation | 917 | 832 |
| Accretion on acquired loans | (91) | (72) |
| Amortization of core deposit intangible | 68 | 67 |
| Net amortization of debt securities available for sale | 626 | 623 |
| (Increase) decrease in accrued interest and dividends receivable | (2,928) | 400 |
| Stock-based compensation expense | 282 | 238 |
| Increase in accrued interest payable | 1,095 | 2,852 |
| Proceeds from sale of mortgage loans held for sale | 15,581 | 24,720 |
| Originations of mortgage loans held for sale | (16,109) | (24,265) |
| Net gain on sale of debt securities available for sale | – | (4) |
| Gain on sale of mortgage loans held for sale | (575) | (518) |
| Net loss on sale of other real estate owned and repossessed assets | 2 | – |
| Write down of other real estate owned and repossessed assets | 20 | 254 |
| Operating losses of tax credit partnerships | 35 | 29 |
| Increase in cash surrender value of life insurance contracts | (762) | (777) |
| Net change in other assets, liabilities, and other operating activities | 2,550 | (3,790) |
| Net cash provided by operating activities | 41,674 | 38,885 |
| INVESTMENT ACTIVITIES | | |
| Purchase of securities available for sale | (65,507) | (54,666) |
| Proceeds from maturities, calls and paydowns of securities available for sale | 28,469 | 20,376 |
| Proceeds from sale of debt securities available for sale | – | 5,100 |
| Purchase of debt securities held to maturity | (250) | – |
| Increase in loans | (129,977) | (78,664) |
| Purchase of premises and equipment | (759) | (556) |
| Proceeds from sale of other real estate owned and repossessed assets | 48 | 874 |
| Net cash used in investing activities | (167,976) | (107,536) |
| FINANCING ACTIVITIES | | |
| Net increase (decrease) in non-interest-bearing deposits | 15,362 | (32,734) |
| Net increase (decrease) in interest-bearing deposits | 152,596 | (81,553) |
| Net increase in federal funds purchased | 84,653 | 24,602 |
| Repayment of Federal Home Loan Bank advances | – | (100) |

Edgar Filing: ServisFirst Bancshares, Inc. - Form 10-Q

| | | |
|---|-----------|-----------|
| Proceeds from exercise of stock options | 797 | 852 |
| Taxes paid in net settlement of tax obligation upon exercise of stock options | (1,453) | (1,247) |
| Dividends paid on common stock | (8,019) | (2,650) |
| Net cash provided by (used in) financing activities | 243,936 | (92,830) |
| Net increase (decrease) in cash and cash equivalents | 117,634 | (161,481) |
| Cash and cash equivalents at beginning of period | 681,895 | 477,586 |
| Cash and cash equivalents at end of period | \$799,529 | \$316,105 |
| SUPPLEMENTAL DISCLOSURE | | |
| Cash paid for: | | |
| Interest | \$23,826 | \$8,721 |
| Income taxes | 1,533 | 2,902 |
| NONCASH TRANSACTIONS | | |
| Other real estate acquired in settlement of loans | \$381 | \$175 |
| Dividends declared | 8,025 | 5,846 |

See Notes to Consolidated Financial Statements.

SERVISFIRST BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2019

(Unaudited)

NOTE 1 - GENERAL

The accompanying consolidated financial statements in this report have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission, including Regulation S-X and the instructions for Form 10-Q, and have not been audited. These consolidated financial statements do not include all of the information and footnotes required by U.S. generally accepted accounting principles (“U.S. GAAP”) for complete financial statements. In the opinion of management, all adjustments necessary to present fairly the consolidated financial position and the consolidated results of operations for the interim periods have been made. All such adjustments are of a normal nature. The consolidated results of operations are not necessarily indicative of the consolidated results of operations which ServisFirst Bancshares, Inc. (the “Company”) may achieve for future interim periods or the entire year. For further information, refer to the consolidated financial statements and footnotes included in the Company’s Form 10-K for the year ended December 31, 2018.

All reported amounts are in thousands except share and per share data.

Leases

The Company leases certain office space and equipment under operating leases. Accounting Standards Update 2016-02, “*Leases (Topic 842)*” requires that operating leases in effect as of date of adoption, January 1, 2019 for the Company, be recognized as a liability to make lease payments and as an asset representing the right to use the asset during the lease term, or “lease liability” and “right-of-use asset”, respectively. The lease liability is measured by the present value of remaining lease payments, discounted at the Company’s incremental borrowing rate.

Certain of the leases include one or more renewal options that extend the initial lease term one to five years. The exercise of lease renewal options is typically at the Company’s sole discretion; therefore, a majority of renewals to extend lease terms are not included in the right-of-use assets and lease liabilities as they are not reasonably certain to be exercised. Renewal options are regularly evaluated and when they are reasonably certain to be exercised, are

included in lease terms.

None of the Company's leases provide an implicit rate. The Company uses its incremental collateralized borrowing rate based on the information available at the lease commencement date in determining the present value of the lease payments. The present value of all existing operating leases was determined using the incremental collateralized borrowing rate on January 1, 2019.

The Company has made an accounting policy election to not apply the recognition requirements in ASU 2016-02 to short-term leases. The Company has also elected to use the practical expedients allowed by the new standard as follows: 1) forego an assessment of whether any existing contracts are or contain leases, 2) forego an assessment of the classification of existing leases as to whether they are operating leases or capital leases, and 3) forego an assessment of direct costs for any existing leases.

NOTE 2 - CASH AND CASH EQUIVALENTS

Cash on hand, cash items in process of collection, amounts due from banks, and federal funds sold are included in cash and cash equivalents.

NOTE 3 - EARNINGS PER COMMON SHARE

Basic earnings per common share are computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per common share include the dilutive effect of additional potential common shares issuable under stock options.

| | Three Months Ended March 31, | |
|--|--|------------|
| | 2019 | 2018 |
| | (In Thousands, Except Shares and Per Share Data) | |
| Earnings per common share | | |
| Weighted average common shares outstanding | 53,465,091 | 53,082,322 |
| Net income available to common stockholders | \$35,010 | \$32,603 |
| Basic earnings per common share | \$0.65 | \$0.61 |
| Weighted average common shares outstanding | 53,465,091 | 53,082,322 |
| Dilutive effects of assumed conversions and exercise of stock options and warrants | 611,447 | 1,101,078 |

Edgar Filing: ServisFirst Bancshares, Inc. - Form 10-Q

| | | |
|--|------------|------------|
| Weighted average common and dilutive potential common shares outstanding | 54,076,538 | 54,183,400 |
| Net income available to common stockholders | \$35,010 | \$32,603 |
| Diluted earnings per common share | \$0.65 | \$0.60 |

NOTE 4 - SECURITIES

The amortized cost and fair value of available-for-sale and held-to-maturity securities at March 31, 2019 and December 31, 2018 are summarized as follows:

| | Amortized Cost | Gross Unrealized Gain | Gross Unrealized Loss | Fair Value |
|---|-------------------|-----------------------------|-----------------------------|------------|
| March 31, 2019 | (In Thousands) | | | |
| Available for sale debt securities | | | | |
| U.S. Treasury and government sponsored agencies | \$74,285 | \$ 126 | \$ (330) | \$74,081 |
| Mortgage-backed securities | 330,444 | 1,392 | (2,460) | 329,376 |
| State and municipal securities | 96,438 | 280 | (250) | 96,468 |
| Corporate debt | 131,802 | 508 | (539) | 131,771 |
| Total | \$632,969 | \$ 2,306 | \$ (3,579) | \$631,696 |
| Held to maturity debt securities | | | | |
| State and municipal securities | \$250 | \$ – | \$ – | \$250 |
| Total | \$250 | \$ – | \$ – | \$250 |
| December 31, 2018 | | | | |
| Available for sale debt securities | | | | |
| U.S. Treasury and government sponsored agencies | \$77,534 | \$ 78 | \$ (619) | \$76,993 |
| Mortgage-backed securities | 309,244 | 591 | (5,531) | 304,304 |
| State and municipal securities | 106,465 | 208 | (679) | 105,994 |
| Corporate debt | 102,982 | 668 | (757) | 102,893 |
| Total | \$596,225 | \$ 1,545 | \$ (7,586) | \$590,184 |

The amortized cost and fair value of debt securities as of March 31, 2019 and December 31, 2018 by contractual maturity are shown below. Actual maturities may differ from contractual maturities of mortgage-backed securities since the mortgages underlying the securities may be called or prepaid with or without penalty. Therefore, these securities are not included in the maturity categories along with the other categories of debt securities.

| | March 31, 2019 | | December 31, 2018 | |
|------------------------------------|-------------------|------------|-------------------|------------|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Available for sale debt securities | (In thousands) | | | |
| Due within one year | \$35,222 | \$35,168 | \$38,343 | \$38,225 |
| Due from one to five years | 170,094 | 169,701 | 167,873 | 166,380 |
| Due from five to ten years | 94,404 | 94,605 | 77,811 | 78,276 |

Edgar Filing: ServisFirst Bancshares, Inc. - Form 10-Q

| | | | | |
|----------------------------------|-----------|-----------|-----------|-----------|
| Due after ten years | 2,805 | 2,846 | 2,954 | 2,999 |
| Mortgage-backed securities | 330,444 | 329,376 | 309,244 | 304,304 |
| | \$632,969 | \$631,696 | \$596,225 | \$590,184 |
| Held to maturity debt securities | | | | |
| Due from one to five years | \$250 | \$250 | \$- | \$- |
| | \$250 | \$250 | \$- | \$- |

All mortgage-backed securities are with government-sponsored enterprises (GSEs) such as Federal National Mortgage Association, Government National Mortgage Association, Federal Home Loan Bank, and Federal Home Loan Mortgage Corporation.

The following table identifies, as of March 31, 2019 and December 31, 2018, the Company's investment securities that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 or more months. At March 31, 2019, 328 of the Company's 752 debt securities had been in an unrealized loss position for 12 or more months. The Company does not intend to sell these securities, and it is more likely than not that the Company will not be required to sell the securities before recovery of their amortized cost, which may be maturity; accordingly, the Company does not consider these securities to be other-than-temporarily impaired at March 31, 2019. Further, the Company believes any deterioration in value of its current investment securities is attributable to changes in market interest rates and not credit quality of the issuer.

| | Less Than Twelve Months | | Twelve Months or More | | Total | |
|---|-------------------------|------------|-------------------------|------------|-------------------------|------------|
| | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value |
| | (In Thousands) | | | | | |
| March 31, 2019 | | | | | | |
| U.S. Treasury and government sponsored agencies | \$(5) | \$1,003 | \$(325) | \$47,913 | \$(330) | \$48,916 |
| Mortgage-backed securities | (203) | 40,066 | (2,257) | 187,872 | (2,460) | 227,938 |
| State and municipal securities | (24) | 4,394 | (226) | 41,231 | (250) | 45,625 |
| Corporate debt | (238) | 33,466 | (301) | 25,191 | (539) | 58,657 |
| Total | \$(470) | \$78,929 | \$(3,109) | \$302,207 | \$(3,579) | \$381,136 |
| December 31, 2018 | | | | | | |
| U.S. Treasury and government sponsored agencies | \$(8) | \$1,001 | \$(611) | \$50,878 | \$(619) | \$51,880 |
| Mortgage-backed securities | (539) | 67,721 | (4,992) | 204,260 | (5,531) | 271,981 |
| State and municipal securities | (101) | 20,821 | (578) | 52,190 | (679) | 73,011 |
| Corporate debt | (315) | 36,245 | (442) | 13,474 | (757) | 49,718 |
| Total | \$(963) | \$125,788 | \$(6,623) | \$320,802 | \$(7,586) | \$446,590 |

The carrying value of investment securities pledged to secure public funds on deposit and for other purposes as required by law was \$314.4 million and \$291.6 million as of March 31, 2019 and December 31, 2018, respectively.

NOTE 5 – LOANS

Edgar Filing: ServisFirst Bancshares, Inc. - Form 10-Q

The following table details the Company's loans at March 31, 2019 and December 31, 2018:

| | March 31, 2019 | December 31, 2018 | | |
|--|------------------------|-------------------------|--------|---|
| | (Dollars In Thousands) | | | |
| Commercial, financial and agricultural | \$2,522,136 | \$2,513,225 | | |
| Real estate - construction | 556,219 | 533,192 | | |
| Real estate - mortgage: | | | | |
| Owner-occupied commercial | 1,500,595 | 1,463,887 | | |
| 1-4 family mortgage | 629,285 | 621,634 | | |
| Other mortgage | 1,394,611 | 1,337,068 | | |
| Subtotal: Real estate - mortgage | 3,524,491 | 3,422,589 | | |
| Consumer | 57,062 | 64,493 | | |
| Total Loans | 6,659,908 | 6,533,499 | | |
| Less: Allowance for loan losses | (70,207) | (68,600) | | |
| Net Loans | \$6,589,701 | \$6,464,899 | | |
| | | | | |
| Commercial, financial and agricultural | 37.87 | % | 38.47 | % |
| Real estate - construction | 8.35 | % | 8.16 | % |
| Real estate - mortgage: | | | | |
| Owner-occupied commercial | 22.53 | % | 22.41 | % |
| 1-4 family mortgage | 9.45 | % | 9.51 | % |
| Other mortgage | 20.94 | % | 20.46 | % |
| Subtotal: Real estate - mortgage | 52.92 | % | 52.38 | % |
| Consumer | 0.86 | % | 0.99 | % |
| Total Loans | 100.00 | % | 100.00 | % |

The credit quality of the loan portfolio is summarized no less frequently than quarterly using categories similar to the standard asset classification system used by the federal banking agencies. The following table presents credit quality indicators for the loan loss portfolio segments and classes. These categories are utilized to develop the associated allowance for loan losses using historical losses adjusted for current economic conditions defined as follows:

- Pass – loans which are well protected by the current net worth and paying capacity of the obligor(s) or by the fair value, less cost to acquire and sell, of any underlying collateral.

- Special Mention – loans with potential weakness that may, if not reversed or corrected, weaken the credit or inadequately protect the Company’s position at some future date. These loans are not adversely classified and do not expose an institution to sufficient risk to warrant an adverse classification.

- Substandard – loans that exhibit well-defined weakness or weaknesses that presently jeopardize debt repayment. These loans are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

- Doubtful – loans that have all the weaknesses inherent in loans classified substandard, plus the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values highly questionable and improbable.

Loans by credit quality indicator as of March 31, 2019 and December 31, 2018 were as follows:

| March 31, 2019 | Pass | Special Mention | Substandard | Doubtful | Total |
|--|----------------|--------------------|-------------|----------|-------------|
| | (In Thousands) | | | | |
| Commercial, financial and agricultural | \$2,456,885 | \$47,075 | \$ 18,176 | \$ – | \$2,522,136 |
| Real estate - construction | 548,656 | 6,944 | 619 | – | 556,219 |
| Real estate - mortgage: | | | | | |
| Owner-occupied commercial | 1,470,108 | 26,929 | 3,558 | – | 1,500,595 |
| 1-4 family mortgage | 625,458 | 1,976 | 1,851 | – | 629,285 |
| Other mortgage | 1,368,451 | 14,781 | 11,379 | – | 1,394,611 |
| Total real estate - mortgage | 3,464,017 | 43,686 | 16,788 | – | 3,524,491 |
| Consumer | 57,013 | 49 | – | – | 57,062 |
| Total | \$6,526,571 | \$97,754 | \$ 35,583 | \$ – | \$6,659,908 |

| December 31, 2018 | Pass | Special Mention | Substandard | Doubtful | Total |
|--|----------------|--------------------|-------------|----------|-------------|
| | (In Thousands) | | | | |
| Commercial, financial and agricultural | \$2,447,052 | \$47,754 | \$ 18,419 | \$ – | \$2,513,225 |
| Real estate - construction | 525,021 | 6,749 | 1,422 | – | 533,192 |

Edgar Filing: ServisFirst Bancshares, Inc. - Form 10-Q

| | | | | | |
|------------------------------|-------------|-----------|-----------|------|-------------|
| Real estate - mortgage: | | | | | |
| Owner-occupied commercial | 1,431,982 | 28,547 | 3,358 | – | 1,463,887 |
| 1-4 family mortgage | 616,884 | 2,703 | 2,047 | – | 621,634 |
| Other mortgage | 1,309,101 | 16,506 | 11,461 | – | 1,337,068 |
| Total real estate - mortgage | 3,357,967 | 47,756 | 16,866 | – | 3,422,589 |
| Consumer | 64,444 | – | 49 | – | 64,493 |
| Total | \$6,394,484 | \$102,259 | \$ 36,756 | \$ – | \$6,533,499 |

Loans by performance status as of March 31, 2019 and December 31, 2018 were as follows:

| March 31, 2019 | Performing | Nonperforming | Total |
|--|----------------|---------------|-------------|
| | (In Thousands) | | |
| Commercial, financial and agricultural | \$2,510,619 | \$ 11,517 | \$2,522,136 |
| Real estate - construction | 555,981 | 238 | 556,219 |
| Real estate - mortgage: | | | |
| Owner-occupied commercial | 1,497,037 | 3,558 | 1,500,595 |
| 1-4 family mortgage | 627,435 | 1,850 | 629,285 |
| Other mortgage | 1,384,611 | 10,000 | 1,394,611 |
| Total real estate - mortgage | 3,509,083 | 15,408 | 3,524,491 |
| Consumer | 57,050 | 12 | 57,062 |
| Total | \$6,632,733 | \$ 27,175 | \$6,659,908 |

| December 31, 2018 | Performing | Nonperforming | Total |
|--|----------------|---------------|-------------|
| | (In Thousands) | | |
| Commercial, financial and agricultural | \$2,502,117 | \$ 11,108 | \$2,513,225 |
| Real estate - construction | 532,195 | 997 | 533,192 |
| Real estate - mortgage: | | | |
| Owner-occupied commercial | 1,460,529 | 3,358 | 1,463,887 |
| 1-4 family mortgage | 619,465 | 2,169 | 621,634 |
| Other mortgage | 1,327,038 | 10,030 | 1,337,068 |
| Total real estate - mortgage | 3,407,032 | 15,557 | 3,422,589 |
| Consumer | 64,385 | 108 | 64,493 |
| Total | \$6,505,729 | \$ 27,770 | \$6,533,499 |

Loans by past due status as of March 31, 2019 and December 31, 2018 were as follows:

| March 31, 2019 | Past Due Status (Accruing Loans) | | | | Non-Accrual | Current | Total Loans |
|--|----------------------------------|---------------|-------------|----------------------|-------------|-------------|-------------|
| | 30-59 Days | 60-89 Days | 90+ Days | Total Past Due | | | |
| | (In Thousands) | | | | | | |
| Commercial, financial and agricultural | \$6,868 | \$2,115 | \$31 | \$9,014 | \$ 11,486 | \$2,501,636 | \$2,522,136 |
| Real estate - construction | – | – | – | – | 238 | 555,981 | 556,219 |
| Real estate - mortgage: | | | | | | | |
| Owner-occupied commercial | 122 | – | – | 122 | 3,558 | 1,496,915 | 1,500,595 |
| 1-4 family mortgage | 600 | 649 | – | 1,249 | 1,850 | 626,186 | 629,285 |
| Other mortgage | 37 | – | 4,978 | 5,015 | 5,022 | 1,384,574 | 1,394,611 |
| Total real estate - mortgage | 759 | 649 | 4,978 | 6,386 | 10,430 | 3,507,675 | 3,524,491 |
| Consumer | 41 | 12 | 12 | 65 | – | 56,997 | 57,062 |

Edgar Filing: ServisFirst Bancshares, Inc. - Form 10-Q

| | | | | | | | |
|-------|---------|---------|---------|----------|-----------|-------------|-------------|
| Total | \$7,668 | \$2,776 | \$5,021 | \$15,465 | \$ 22,154 | \$6,622,289 | \$6,659,908 |
|-------|---------|---------|---------|----------|-----------|-------------|-------------|

| December 31, 2018 | Past Due Status (Accruing Loans) | | | | Non-Accrual | Current | Total Loans |
|--|----------------------------------|---------------|-------------|----------------------|-------------|-------------|-------------|
| | 30-59 Days | 60-89 Days | 90+ Days | Total Past Due | | | |
| | (In Thousands) | | | | | | |
| Commercial, financial and agricultural | \$1,222 | \$48 | \$605 | \$1,875 | \$ 10,503 | \$2,500,847 | \$2,513,225 |
| Real estate - construction | – | 1,352 | – | 1,352 | 997 | 530,843 | 533,192 |
| Real estate - mortgage: | | | | | | | |
| Owner-occupied commercial | 412 | – | – | 412 | 3,358 | 1,460,117 | 1,463,887 |
| 1-4 family mortgage | 534 | 235 | 123 | 892 | 2,046 | 618,696 | 621,634 |
| Other mortgage | 1,174 | – | 5,008 | 6,182 | 5,022 | 1,325,864 | 1,337,068 |
| Total real estate - mortgage | 2,120 | 235 | 5,131 | 7,486 | 10,426 | 3,404,677 | 3,422,589 |
| Consumer | 58 | 123 | 108 | 289 | – | 64,204 | 64,493 |
| Total | \$3,400 | \$1,758 | \$5,844 | \$11,002 | \$ 21,926 | \$6,500,571 | \$6,533,499 |

The allowance for loan losses is maintained at a level which, in management's judgment, is adequate to absorb credit losses inherent in the loan portfolio. The amount of the allowance is based on management's evaluation of the collectability of the loan portfolio, including the nature of the portfolio, credit concentrations, trends in historical loss experience, specific impaired loans, economic conditions, and other risks inherent in the portfolio. Allowances for impaired loans are generally determined based on collateral values or the present value of the estimated cash flows. The allowance is increased by a provision for loan losses, which is charged to expense, and reduced by charge-offs, net of recoveries. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for losses on loans. Such agencies may require the Company to recognize adjustments to the allowance based on their judgments about information available to them at the time of their examination.

The methodology utilized for the calculation of the allowance for loan losses is divided into four distinct categories. Those categories include allowances for non-impaired loans (ASC 450), impaired loans (ASC 310), external qualitative factors, and internal qualitative factors. A description of each category of the allowance for loan loss methodology is listed below.

Non-Impaired Loans. Non-impaired loans are grouped into the following homogeneous loan pools by loan type: commercial and industrial, construction and development, commercial real estate, second lien home equity lines of credit, and all other loans. Each loan pool is stratified by internal risk rating and multiplied by a loss allocation percentage derived from the loan pool historical loss rate. The historical loss rate is based on an age weighted five year history of net charge-offs experienced by pool, with the most recent net charge-off experience given a greater weighting. This results in the expected loss rate per year, adjusted by a qualitative adjustment factor and a years-to-impairment factor, for each pool of loans to derive the total amount of allowance for non-impaired loans.

Impaired Loans. Loans are considered impaired, when based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. The collection of all amounts due according to contractual terms means that both the contractual interest and principal payments of a loan will be collected as scheduled in the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the rate implicit in the original loan agreement, at the loan's observable market price or the fair value of the underlying collateral. The fair value of collateral, reduced by costs to sell on a discounted basis, is used if a loan is collateral-dependent. Fair value estimates for specifically impaired collateral-dependent loans are derived from appraised values based on the current market value or "as is" value of the property, normally from recently received and reviewed appraisals. Appraisals are obtained from certified and licensed appraisers and are based on certain assumptions, which may include construction or development status and the highest and best use of the property. These appraisals are reviewed by our credit administration department, and values are adjusted downward to reflect anticipated disposition costs. Once this estimated net realizable value has been determined, the value used in the impairment assessment is updated for each impaired loan. As subsequent events dictate and estimated net realizable values decline, required reserves may be established or further adjustments recorded.

External Qualitative Factors. The determination of the portion of the allowance for loan losses relating to external qualitative factors is based on consideration of the following factors: gross domestic product growth rate, changes in prime rate, delinquency trends, peer delinquency trends, year over year loan growth and state unemployment rate trends. Data for the three most recent periods is utilized in the calculation for each external qualitative component. The factors have a consistent weighted methodology to calculate the amount of allowance due to external qualitative factors.

Internal Qualitative Factors. The determination of the portion of the allowance for loan losses relating to internal qualitative factors is based on the consideration of criteria which includes the following: number of extensions and deferrals, single pay and interest only loans, current financial information, credit concentrations and risk grade accuracy. A self-assessment for each of the criteria is made with a consistent weighted methodology used to calculate the amount of allowance required for internal qualitative factors.

The following table presents an analysis of the allowance for loan losses by portfolio segment and changes in the allowance for loan losses for the three months ended March 31, 2019 and March 31, 2018. The total allowance for loan losses is disaggregated into those amounts associated with loans individually evaluated and those associated with loans collectively evaluated.

| | Commercial, financial and agricultural | Real estate - construction | Real estate - mortgage | Consumer | Total |
|---------------------------------------|---|-------------------------------|---------------------------|----------|-------------|
| (In Thousands) | | | | | |
| Three Months Ended March 31, 2019 | | | | | |
| Allowance for loan losses: | | | | | |
| Balance at December 31, 2018 | \$39,016 | \$ 3,522 | \$25,508 | \$ 554 | \$68,600 |
| Charge-offs | (3,037) | – | (50) | (218) | (3,305) |
| Recoveries | 12 | 1 | 7 | 7 | 27 |
| Provision | 3,468 | 72 | 1,246 | 99 | 4,885 |
| Balance at March 31, 2019 | \$39,459 | \$ 3,595 | \$26,711 | \$442 | \$70,207 |
| Three Months Ended March 31, 2018 | | | | | |
| Allowance for loan losses: | | | | | |
| Balance at December 31, 2017 | \$32,880 | \$ 4,989 | \$21,022 | \$ 515 | \$59,406 |
| Charge-offs | (1,088) | – | (381) | (88) | (1,557) |
| Recoveries | 4 | 7 | 42 | 9 | 62 |
| Provision | 3,991 | (858) | 923 | 83 | 4,139 |
| Balance at March 31, 2018 | \$35,787 | \$ 4,138 | \$21,606 | \$ 519 | \$62,050 |
| As of March 31, 2019 | | | | | |
| Allowance for loan losses: | | | | | |
| Individually Evaluated for Impairment | \$5,192 | \$ 110 | \$1,987 | \$– | \$7,289 |
| Collectively Evaluated for Impairment | 34,267 | 3,485 | 24,724 | 442 | 62,918 |
| Loans: | | | | | |
| Ending Balance | \$2,522,136 | \$ 556,219 | \$3,524,491 | \$57,062 | \$6,659,908 |
| Individually Evaluated for Impairment | 18,197 | 656 | 17,891 | 49 | 36,793 |
| Collectively Evaluated for Impairment | 2,503,939 | 555,563 | 3,506,600 | 57,013 | 6,623,115 |
| As of December 31, 2018 | | | | | |
| Allowance for loan losses: | | | | | |
| Individually Evaluated for Impairment | \$6,066 | \$ 126 | \$1,887 | \$49 | \$8,128 |
| Collectively Evaluated for Impairment | 32,950 | 3,396 | 23,621 | 505 | 60,472 |
| Loans: | | | | | |
| Ending Balance | \$2,513,225 | \$ 533,192 | \$3,422,589 | \$64,493 | \$6,533,499 |
| Individually Evaluated for Impairment | 18,444 | 1,461 | 18,637 | 49 | 38,591 |
| Collectively Evaluated for Impairment | 2,494,781 | 531,731 | 3,403,952 | 64,444 | 6,494,908 |

The following table presents details of the Company's impaired loans as of March 31, 2019 and December 31, 2018, respectively. Loans which have been fully charged off do not appear in the table.

| | March 31, 2019 | | | For the three months ended March 31, 2019 | |
|--|------------------------------------|--------------------------|-------------------|---|--------------------------------------|
| | Recorded Investment (In Thousands) | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized in Period |
| With no allowance recorded: | | | | | |
| Commercial, financial and agricultural | \$5,447 | \$5,947 | \$ – | \$5,947 | \$ 49 |
| Real estate - construction | 418 | 421 | – | 454 | 7 |
| Real estate - mortgage: | | | | | |
| Owner-occupied commercial | 1,096 | 1,192 | – | 1,102 | 16 |
| 1-4 family mortgage | 597 | 597 | – | 622 | (1) |
| Other mortgage | 4,978 | 4,978 | – | 4,992 | 61 |
| Total real estate - mortgage | 6,671 | 6,767 | – | 6,716 | 76 |
| Consumer | – | – | – | – | – |
| Total with no allowance recorded | 12,536 | 13,135 | – | 13,117 | 132 |
| With an allowance recorded: | | | | | |
| Commercial, financial and agricultural | 12,750 | 22,855 | 5,192 | 15,416 | 30 |
| Real estate - construction | 238 | 238 | 110 | 364 | – |
| Real estate - mortgage: | | | | | |
| Owner-occupied commercial | 3,558 | 3,558 | 106 | 3,558 | (1) |
| 1-4 family mortgage | 1,253 | 1,253 | 301 | 1,253 | – |
| Other mortgage | 6,409 | 6,409 | 1,580 | 6,409 | 15 |
| Total real estate - mortgage | 11,220 | 11,220 | 1,987 | 11,220 | 14 |
| Consumer | 49 | 49 | – | 49 | 1 |
| Total with allowance recorded | 24,257 | 34,362 | 7,289 | 27,049 | 45 |
| Total Impaired Loans: | | | | | |
| Commercial, financial and agricultural | 18,197 | 28,802 | 5,192 | 21,363 | 79 |
| Real estate - construction | 656 | 659 | 110 | 818 | 7 |
| Real estate - mortgage: | | | | | |
| Owner-occupied commercial | 4,654 | 4,750 | 106 | 4,660 | 15 |
| 1-4 family mortgage | 1,850 | 1,850 | 301 | 1,875 | (1) |
| Other mortgage | 11,387 | 11,387 | 1,580 | 11,401 | 76 |
| Total real estate - mortgage | 17,891 | 17,987 | 1,987 | 17,936 | 90 |
| Consumer | 49 | 49 | – | 49 | 1 |
| Total impaired loans | \$36,793 | \$47,497 | \$ 7,289 | \$40,166 | \$ 177 |

| | December 31, 2018 | | | For the twelve months ended December 31, 2018 | |
|--|------------------------------------|--------------------------|-------------------|---|-------------------------------|
| | Recorded Investment (In Thousands) | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Recognized In Period |
| With no allowance recorded: | | | | | |
| Commercial, financial and agricultural | \$6,064 | \$6,064 | \$ – | \$6,142 | \$ 237 |
| Real estate - construction | 464 | 467 | – | 524 | 28 |
| Real estate - mortgage: | | | | | |
| Owner-occupied commercial | 1,763 | 1,947 | – | 2,223 | 120 |
| 1-4 family mortgage | 1,071 | 1,071 | – | 1,088 | 21 |
| Other mortgage | 5,061 | 5,061 | – | 5,133 | 252 |
| Total real estate - mortgage | 7,895 | 8,079 | – | 8,444 | 393 |
| Consumer | – | – | – | – | – |
| Total with no allowance recorded | 14,423 | 14,610 | – | 15,110 | 658 |
| With an allowance recorded: | | | | | |
| Commercial, financial and agricultural | 12,380 | 20,141 | 6,066 | 15,918 | 462 |
| Real estate - construction | 997 | 997 | 126 | 997 | 31 |
| Real estate - mortgage: | | | | | |
| Owner-occupied commercial | 3,358 | 3,358 | 99 | 3,364 | 105 |
| 1-4 family mortgage | 975 | 975 | 208 | 975 | 30 |
| Other mortgage | 6,409 | 6,409 | 1,580 | 6,598 | 217 |
| Total real estate - mortgage | 10,742 | 10,742 | 1,887 | 10,937 | 352 |
| Consumer | 49 | 49 | 49 | 49 | 3 |
| Total with allowance recorded | 24,168 | 31,929 | 8,128 | 27,901 | 848 |
| Total Impaired Loans: | | | | | |
| Commercial, financial and agricultural | 18,444 | 26,205 | 6,066 | 22,060 | 699 |
| Real estate - construction | 1,461 | 1,464 | 126 | 1,521 | 59 |
| Real estate - mortgage: | | | | | |
| Owner-occupied commercial | 5,121 | 5,305 | 99 | 5,587 | 225 |
| 1-4 family mortgage | 2,046 | 2,046 | 208 | 2,063 | 51 |
| Other mortgage | 11,470 | 11,470 | 1,580 | 11,731 | 469 |
| Total real estate - mortgage | 18,637 | 18,821 | 1,887 | 19,381 | 745 |
| Consumer | 49 | 49 | 49 | 49 | 3 |
| Total impaired loans | \$38,591 | \$46,539 | \$ 8,128 | \$43,011 | \$ 1,506 |

Troubled Debt Restructurings (“TDR”) at March 31, 2019, December 31, 2018 and March 31, 2018 totaled \$12.3 million, \$14.6 million and \$18.8 million, respectively. The portion of those TDRs accruing interest at March 31, 2019, December 31, 2018 and March 31, 2018 totaled \$2.7 million, \$3.1 million and \$15.8 million, respectively. At March 31, 2019, the Company had a related allowance for loan losses of \$2.6 million allocated to TDRs, compared to \$4.3

million at December 31, 2018 and \$5.1 million at March 31, 2018. There were no modifications made to new TDRs or renewals of existing TDRs for the three months ended March 31, 2019 and 2018.

There were two commercial loans totaling \$0.3 million which were modified in the previous twelve months (i.e., the twelve months prior to default) which defaulted during the three months ended March 31, 2019. There were no loans which were modified in the previous twelve months that defaulted during the three months ended March 31, 2018. For purposes of this disclosure, default is defined as 90 days past due and still accruing or placement on nonaccrual status.

NOTE 6 – LEASES

The Company leases space under non-cancelable operating leases for several of its banking offices and certain office equipment. The leases have remaining terms up to 10 years. At March 31, 2019, the Company had lease right-of-use assets and lease liabilities totaling \$14.7 million, which are reflected in other assets and other liabilities, respectively, in the Company's Consolidated Balance Sheet.

Maturities of operating lease liabilities as of March 31, 2019 are as follows:

| | March 31, 2019 (In Thousands) |
|--|--|
| 2019 (remaining) | \$ 2,397 |
| 2020 | 3,134 |
| 2021 | 2,487 |
| 2022 | 2,509 |
| 2023 | 2,088 |
| thereafter | 3,701 |
| Total lease payments | 16,316 |
| Less: imputed interest | (1,637) |
| Present value of operating lease liabilities | \$ 14,679 |

As of March 31, 2019 the weighted average remaining term of operating leases is 6.2 years and the weighted average discount rate used in the measurement of operating lease liabilities was 5.00%.

An initial right-of-use asset of \$15.3 million was recognized as a non-cash asset addition with the adoption of the new lease accounting standard on January 1, 2019. Additional right-of-use assets of \$0.4 million were recorded as non-cash asset additions that resulted from new operating lease liabilities during the first quarter 2019. Cash paid for amounts included in the present value of operating lease liabilities was \$0.8 million during the first quarter 2019 and is included in operating cash flows.

Operating lease costs were \$0.9 million during the first quarter 2019. Variable lease costs were \$0.1 million during the first quarter 2019. Short-term lease costs were \$7,000 during the first quarter 2019. Prior to the adoption of the new lease accounting standard, we had rent expense of \$0.7 million for the first quarter ended 2018.

NOTE 7 - EMPLOYEE AND DIRECTOR BENEFITS

Stock Options

At March 31, 2019, the Company had stock incentive plans as described below. The compensation cost that has been charged to earnings for the plans was approximately \$0.3 million and \$0.2 million for the three months ended March 31, 2019 and 2018, respectively.

The Company's 2009 Amended and Restated Stock Incentive Plan authorizes the grant of up to 5,550,000 shares and allows for the issuance of Stock Appreciation Rights, Restricted Stock, Stock Options, Non-stock Share Equivalents, Performance Shares or Performance Units. Both plans allow for the grant of incentive stock options and non-qualified stock options, and option awards are granted with an exercise price equal to the fair market value of the Company's common stock at the date of grant. The maximum term of the options granted under the plans is ten years.

The Company estimates the fair value of each stock option award using a Black-Scholes-Merton valuation model which incorporates the assumptions noted in the following table. Expected volatilities are based on an index of southeastern United States publicly traded banks. The expected term for options granted is based on the short-cut method and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U. S. Treasury yield curve in effect at the time of grant.

| | 2019 | 2018 |
|--------------------------|--------|--------|
| Expected volatility | 40.00% | 23.43% |
| Expected dividends | 1.76 % | 1.07 % |
| Expected term (in years) | 6.3 | 6.3 |
| Risk-free rate | 2.61 % | 2.67 % |

The weighted average grant-date fair value of options granted during the three months ended March 31, 2019 and 2018 was \$12.20 and \$10.41, respectively.

The following table summarizes stock option activity during the three months ended March 31, 2019 and 2018:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (years) | Aggregate Intrinsic Value (In Thousands) |
|------------------------------------|------------|--|--|--|
| Three Months Ended March 31, 2019: | | | | |
| Outstanding January 1, 2019 | 1,238,748 | \$ 13.02 | 5.2 | \$ 23,355 |
| Granted | 6,000 | 34.09 | 9.8 | (2) |
| Exercised | (162,500) | 4.59 | 1.7 | 4,384 |
| Forfeited | — | — | — | — |
| Outstanding March 31, 2019 | 1,082,248 | 14.41 | 6.3 | \$ 21,318 |
| Exercisable March 31, 2019 | 354,800 | \$ 8.40 | 4.0 | \$ 9,356 |
| Three Months Ended March 31, 2018: | | | | |
| Outstanding January 1, 2018 | 1,666,834 | \$ 10.68 | 5.5 | \$ 51,377 |
| Granted | 10,250 | 41.21 | 9.9 | (4) |
| Exercised | (173,836) | 4.90 | 3.4 | 6,244 |
| Forfeited | (1,000) | 25.41 | 8.5 | 15 |
| Outstanding March 31, 2018 | 1,502,248 | 11.54 | 5.5 | \$ 43,978 |

| | | | | |
|----------------------------|---------|---------|-----|-----------|
| Exercisable March 31, 2018 | 672,600 | \$ 5.48 | 3.9 | \$ 23,770 |
|----------------------------|---------|---------|-----|-----------|

As of March 31, 2019, there was \$1.6 million of total unrecognized compensation cost related to non-vested stock options. The cost is expected to be recognized on the straight-line method over the next 1.8 years.

Restricted Stock

The Company periodically grants restricted stock awards that vest upon service conditions. Dividend payments are made during the vesting period. The value of restricted stock is determined to be the current value of the Company's stock, and this total value will be recognized as compensation expense over the vesting period. There were 15,200 shares of restricted stock granted to employees during the first quarter of 2019. There were 10,750 shares of restricted stock granted to employees during the first quarter of 2018. As of March 31, 2019, there was \$1.2 million of total unrecognized compensation cost related to non-vested restricted stock. As of March 31, 2019, non-vested restricted stock had a weighted average remaining time to vest of 3.2 years.

NOTE 8 - DERIVATIVES

The Company has entered into agreements with secondary market investors to deliver loans on a "best efforts delivery" basis. When a rate is committed to a borrower, it is based on the best price that day and locked with the investor for the customer for a 30-day period. In the event the loan is not delivered to the investor, the Company has no risk or exposure with the investor. The interest rate lock commitments related to loans that are originated for later sale are classified as derivatives. The fair values of the Company's agreements with investors and rate lock commitments to customers as of March 31, 2019 and December 31, 2018 were not material.

NOTE 9 – RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“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 were effective for the Company on January 1, 2019. The Company elected the three practical expedients allowed by the amendments as follows: 1) forego an assessment of whether any existing contracts are or contain leases, 2) forego an assessment of the classification of existing leases as to whether they are operating leases or capital leases, and 3) forego an assessment of direct costs for any existing leases. Upon adoption on January 1, 2019, the Company recorded right-of-use assets and related lease liabilities of \$15.3 million and did not restate comparative periods. There was no impact on the Company’s consolidated statements of income or cash flows. See Note 6 – Leases for additional information.

In June 2018, the FASB issued ASU 2018-07, *Compensation – Stock Compensation (Topic 718), Improvements to Nonemployee Share-Based Payment Accounting*. These amendments expand the scope of Topic 718, Compensation - Stock Compensation, which only included share-based payments to employees, to include share-based payments issued to nonemployees for goods or services. Consequently, the accounting for share-based payments to nonemployees and employees are now substantially aligned. The ASU superseded Subtopic 505-50, Equity – Equity-Based Payments to Non-Employees. The Company adopted this ASU effective January 1, 2019. However, the amendments did not have an impact on the Company’s Consolidated Financial Statements because it does not currently have any stock-based payment awards outstanding to nonemployees.

In March 2017, the FASB issued ASU 2017-08, *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities*. The amendments shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The amendments in this ASU were effective for the Company as of January 1, 2019. The amendments in this ASU did not impact the Company’s Consolidated Financial Statements, as it has always amortized premiums to the first call date.

NOTE 10 – RECENT ACCOUNTING PRONOUNCEMENTS

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, which is essentially the final rule on use of the so-called CECL model, or current expected credit losses. Among other things, the amendments in this ASU require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions,

and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For SEC filers, the amendments in this ASU are effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2019, with later effective dates for non-SEC registrant public companies and other organizations. Early adoption will be permitted for all organizations for fiscal years and interim periods within those fiscal years beginning after December 15, 2018. The Company has contracted with a third-party provider for enhanced modeling techniques that incorporate the loss measurement requirements in these amendments. The Company is currently working through its implementation plan and will be testing the effectiveness of the new model through analytics and comparison with its existing incurred loss model throughout 2019.

In July 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. This ASU eliminates, adds and modifies certain disclosure requirements for fair value measurements. Among the changes, entities will no longer be required to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, however, entities will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. ASU No. 2018-13 is effective for interim and annual reporting periods beginning after December 15, 2019; early adoption is permitted. Entities are also allowed to elect early adoption of the eliminated or modified disclosure requirements and delay adoption of the new disclosure requirements until their effective date. As ASU No. 2018-13 only revises disclosure requirements, it will not have a material impact on the Company's Consolidated Financial Statements.

NOTE 11 - FAIR VALUE MEASUREMENT

Measurement of fair value under U.S. GAAP establishes a hierarchy that prioritizes observable and unobservable inputs used to measure fair value, as of the measurement date, into three broad levels, which are described below:

- Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.
- Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.
- Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible and also considers counterparty credit risk in its assessment of fair value.

Debt Securities. Where quoted prices are available in an active market, securities are classified within Level 1 of the hierarchy. Level 1 securities include highly liquid government securities such as U.S. Treasuries and exchange-traded equity securities. For securities traded in secondary markets for which quoted market prices are not available, the Company generally relies on pricing services provided by independent vendors. Such independent pricing services are to advise the Company on the carrying value of the securities available for sale portfolio. As part of the Company's procedures, the price provided from the service is evaluated for reasonableness given market changes. When a questionable price exists, the Company investigates further to determine if the price is valid. If needed, other market participants may be utilized to determine the correct fair value. The Company has also reviewed and confirmed its determinations in discussions with the pricing source regarding their methods of price discovery. Securities measured with these techniques are classified within Level 2 of the hierarchy and often involve using quoted market prices for similar securities, pricing models or discounted cash flow calculations using inputs observable in the market where available. Examples include U.S. government agency securities, mortgage-backed securities, obligations of states and political subdivisions, and certain corporate, asset-backed and other securities. In cases where Level 1 or Level 2 inputs are not available, securities are classified in Level 3 of the hierarchy.

Impaired Loans. Impaired loans are measured and reported at fair value when full payment under the loan terms is not probable. Impaired loans are carried at the present value of expected future cash flows using the loan's existing rate in a discounted cash flow calculation, or the fair value of the collateral if the loan is collateral-dependent. Expected cash flows are based on internal inputs reflecting expected default rates on contractual cash flows. This method of estimating fair value follows the exit-price concept of fair value described in Accounting Standards Codification ("ASC") 820-10. For loans measured using the estimated fair value of collateral less costs to sell, fair value is generally

determined based on appraisals performed by certified and licensed appraisers using inputs such as absorption rates, capitalization rates, and market comparables, adjusted for estimated costs to sell. Management modifies the appraised values, if needed, to take into account recent developments in the market or other factors, such as changes in absorption rates or market conditions from the time of valuation, and anticipated sales values considering management's plans for disposition. Such modifications to the appraised values could result in lower valuations of such collateral. Estimated costs to sell are based on current amounts of disposal costs for similar assets. These measurements are classified as Level 3 within the valuation hierarchy. Impaired loans are subject to nonrecurring fair value adjustment upon initial recognition or subsequent impairment. A portion of the allowance for loan losses is allocated to impaired loans if the value of such loans is deemed to be less than the unpaid balance. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly based on the same factors identified above. The amount recognized as an impairment charge related to impaired loans that are measured at fair value on a nonrecurring basis was \$1.9 million during the three months ended March 31, 2019, and \$2.3 million during the three months ended March 31, 2018.

Other Real Estate Owned. Other real estate assets ("OREO") acquired through, or in lieu of, foreclosure are held for sale and are initially recorded at the lower of cost or fair value, less selling costs. Any write-downs to fair value at the time of transfer to OREO are charged to the allowance for loan losses subsequent to foreclosure. Values are derived from appraisals of underlying collateral and discounted cash flow analysis. Appraisals are performed by certified and licensed appraisers. Subsequent to foreclosure, valuations are updated periodically and assets are marked to current fair value, not to exceed the new cost basis. In the determination of fair value subsequent to foreclosure, management also considers other factors or recent developments, such as changes in absorption rates and market conditions from the time of valuation, and anticipated sales values considering management's plans for disposition, which could result in adjustment to lower the property value estimates indicated in the appraisals. These measurements are classified as Level 3 within the valuation hierarchy. A loss on the sale and write-downs of OREO of \$22,000 and \$254,000 was recognized during the three months ended March 31, 2019 and 2018, respectively. These charges were for write-downs in the value of OREO subsequent to foreclosure and losses on the disposal of OREO. OREO is classified within Level 3 of the hierarchy.

There was one residential real estate loan with a balance of \$340,000 foreclosed and classified as OREO as of March 31, 2019. This same loan had a balance of \$360,000 as of December 31, 2018.

No residential real estate loans were in the process of being foreclosed as of March 31, 2019 and one residential real estate loan for \$173,000 was in the process of being foreclosed as of December 31, 2018. This property was eventually purchased by another buyer at auction.

The following table presents the Company's financial assets carried at fair value on a recurring basis as of March 31, 2019 and December 31, 2018. There were no liabilities measured at fair value on a recurring basis as of March 31, 2019 and December 31, 2018.

| | Fair Value Measurements at March 31, 2019 Using | | | Total |
|---|--|--|--|-----------|
| | Quoted Prices in Active Markets for Identifiable Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| Assets Measured on a Recurring Basis: | (In Thousands) | | | |
| Available for sale debt securities: | | | | |
| U.S. Treasury and government sponsored agencies | \$– | \$74,081 | \$– | \$74,081 |
| Mortgage-backed securities | – | 329,376 | – | 329,376 |
| State and municipal securities | – | 96,468 | – | 96,468 |
| Corporate debt | – | 125,268 | 6,503 | 131,771 |
| Total assets at fair value | \$– | \$625,193 | \$6,503 | \$631,696 |

| | Fair Value Measurements at December 31, 2018 Using | | | Total |
|---------------------------------------|--|--|--|-------|
| | Quoted Prices in Active Markets for Identifiable Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| Assets Measured on a Recurring Basis: | (In Thousands) | | | |
| Available for sale debt securities: | | | | |

Edgar Filing: ServisFirst Bancshares, Inc. - Form 10-Q

| | | | | |
|---|-----|-----------|----------|-----------|
| U.S. Treasury and government sponsored agencies | \$– | \$76,993 | \$ – | \$76,993 |
| Mortgage-backed securities | – | 304,304 | – | 304,304 |
| State and municipal securities | – | 105,994 | – | 105,994 |
| Corporate debt | – | 96,375 | 6,518 | 102,893 |
| Total assets at fair value | \$– | \$583,666 | \$ 6,518 | \$590,184 |

The following table presents the Company's financial assets carried at fair value on a nonrecurring basis as of March 31, 2019 and December 31, 2018. There were no liabilities measured at fair value on a non-recurring basis as of March 31, 2019 and December 31, 2018.

| | Fair Value Measurements at March 31, 2019 Using Quoted Prices in Active Markets for Identifiable Assets (Level 1) | | | Significant Unobservable Inputs (Level 3) | Total |
|--|--|------|-----------|--|----------|
| Assets Measured on a Nonrecurring Basis: | (In Thousands) | | | | |
| Impaired loans | \$– | \$ – | \$ 29,504 | | \$29,504 |
| Other real estate owned and repossessed assets | – | – | 5,480 | | 5,480 |
| Total assets at fair value | \$– | \$ – | \$ 34,984 | | \$34,984 |

| | Fair Value Measurements at December 31, 2018 Using Quoted Prices in Active Markets for Identifiable Assets (Level 1) | | | Significant Unobservable Inputs (Level 3) | Total |
|--|---|------|-----------|--|----------|
| Assets Measured on a Nonrecurring Basis: | (In Thousands) | | | | |
| Impaired loans | \$– | \$ – | \$ 30,463 | | \$30,463 |
| Other real estate owned | – | – | 5,169 | | 5,169 |
| Total assets at fair value | \$– | \$ – | \$ 35,632 | | \$35,632 |

The fair value of a financial instrument is the current amount that would be exchanged in a sale between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Current U.S. GAAP excludes certain financial instruments and all nonfinancial instruments from its fair value disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

The estimated fair values of the Company's financial instruments not measured at fair value on a recurring or non-recurring basis as of March 31, 2019 and December 31, 2018 were as follows:

| | March 31, 2019 | | December 31, 2018 | |
|----------------------------------|--------------------|-------------|--------------------|-------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| | (In Thousands) | | | |
| Financial Assets: | | | | |
| Level 1 inputs: | | | | |
| Cash and cash equivalents | \$618,094 | \$618,094 | \$458,050 | \$458,050 |
| Level 2 inputs: | | | | |
| Federal funds sold | 181,435 | 181,435 | 223,845 | 223,845 |
| Mortgage loans held for sale | 1,223 | 1,251 | 120 | 121 |
| Level 3 Inputs: | | | | |
| Held to maturity debt securities | 250 | 250 | — | — |
| Loans, net | 6,589,701 | 6,555,511 | 6,464,899 | 6,398,604 |
| Financial Liabilities: | | | | |
| Level 2 inputs: | | | | |
| Deposits | \$7,083,666 | \$7,082,114 | \$6,915,708 | \$6,910,176 |
| Federal funds purchased | 373,378 | 373,378 | 288,725 | 288,725 |
| Other borrowings | 64,675 | 64,618 | 64,666 | 64,613 |

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

The following discussion and analysis is designed to provide a better understanding of various factors relating to the results of operations and financial condition of ServisFirst Bancshares, Inc. (the “Company”) and its wholly owned subsidiary, ServisFirst Bank (the “Bank”). This discussion is intended to supplement and highlight information contained in the accompanying unaudited consolidated balance sheets as of March 31, 2019 and December 31, 2018 and consolidated statements of income for the three months ended March 31, 2019 and March 31, 2018.

Forward-Looking Statements

Statements in this document that are not historical facts, including, but not limited to, statements concerning future operations, results or performance, are hereby identified as “forward-looking statements” for the purpose of the safe harbor provided by Section 21E of the Securities Exchange Act of 1934 and Section 27A of the Securities Act of 1933. The words “believe,” “expect,” “anticipate,” “project,” “plan,” “intend,” “will,” “would,” “might” and similar expressions signify forward-looking statements. Such statements involve inherent risks and uncertainties. The Company cautions that such forward-looking statements, wherever they occur in this quarterly report or in other statements attributable to the Company, are necessarily estimates reflecting the judgment of the Company’s senior management and involve a number of risks and uncertainties that could cause actual results to differ materially from those suggested by the forward-looking statements. Such forward-looking statements should, therefore, be considered in light of various factors that could affect the accuracy of such forward-looking statements, including, but not limited to: general economic conditions, especially in the credit markets and in the Southeast; the performance of the capital markets; changes in interest rates, yield curves and interest rate spread relationships; changes in accounting and tax principles, policies or guidelines; changes in legislation or regulatory requirements; changes in our loan portfolio and deposit base; possible changes in laws and regulations and governmental monetary and fiscal policies; the cost and other effects of legal and administrative cases and similar contingencies; possible changes in the creditworthiness of customers and the possible impairment of the collectability of loans and the value of collateral; the effect of natural disasters, such as hurricanes and tornados, in our geographic markets; and increased competition from both banks and non-banks. The foregoing list of factors is not exhaustive. For discussion of these and other risks that may cause actual results to differ from expectations, please refer to “Cautionary Note Regarding Forward Looking Statements” and “Risk Factors” in our most recent Annual Report on Form 10-K and our other SEC filings. If one or more of the factors affecting our forward-looking information and statements proves incorrect, then our actual results, performance or achievements could differ materially from those expressed in, or implied by, forward-looking information and statements. Accordingly, you should not place undue reliance on any forward-looking statements, which speak only as of the date made. The Company assumes no obligation to update or revise any forward-looking statements that are made from time to time.

Business

We are a bank holding company under the Bank Holding Company Act of 1956 and are headquartered in Birmingham, Alabama. Our wholly-owned subsidiary, ServisFirst Bank, an Alabama banking corporation, provides commercial banking services through 20 full-service banking offices located in Alabama, Tampa Bay, Florida, the panhandle of Florida, the greater Atlanta, Georgia metropolitan area, Charleston, South Carolina, and Nashville, Tennessee. Through the bank, we originate commercial, consumer and other loans and accept deposits, provide electronic banking services, such as online and mobile banking, including remote deposit capture, deliver treasury and cash management services and provide correspondent banking services to other financial institutions.

Our principal business is to accept deposits from the public and to make loans and other investments. Our principal sources of funds for loans and investments are demand, time, savings, and other deposits. Our principal sources of income are interest and fees collected on loans, interest and dividends collected on other investments and service charges. Our principal expenses are interest paid on savings and other deposits, interest paid on our other borrowings, employee compensation, office expenses and other overhead expenses.

Overview

As of March 31, 2019, we had consolidated total assets of \$8.31 billion, up \$30.0 million, or 3.8%, from total assets of \$8.01 billion at December 31, 2018. Total loans were \$6.66 billion at March 31, 2019, up \$126.4 million, or 1.9%, from \$6.53 billion at December 31, 2018. Total deposits were \$0.37 billion at March 31, 2019, up \$167.9 million, or 29.3%, from \$0.29 billion at December 31, 2018.

Net income available to common stockholders for the three months ended March 31, 2019 was \$35.0 million, up \$2.4 million, or 7.4%, from \$32.6 million for the three months ended March 31, 2018. Basic and diluted earnings per common share were \$0.65 for the three months ended March 31, 2019, compared to \$0.61 and \$0.60, respectively, for the corresponding period in 2018. An increase in net interest income of \$5.6 million for the comparative periods contributed to the increase in net income. Partially offsetting the increase in net interest income were increases in salary expenses, other operating expenses, and provision for income taxes. Changes in income and expenses are more fully explained in “Results of Operations” below.

Critical Accounting Policies

The accounting and financial policies of the Company conform to U.S. GAAP and to general practices within the banking industry. To prepare consolidated financial statements in conformity with U.S. generally accepted accounting principles, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ. The allowance for loan losses, valuation of foreclosed real estate, deferred taxes, and fair value of financial instruments are particularly subject to change. Information concerning our accounting policies with respect to these items is available in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018.

Financial Condition

Cash and Cash Equivalents

At March 31, 2019, we had \$181.4 million in federal funds sold, compared to \$223.8 million at December 31, 2018. We also maintain balances at the Federal Reserve Bank of Atlanta, which earn interest. At March 31, 2019, we had \$192.9 million in balances at the Federal Reserve, compared to \$41.9 million at December 31, 2018. Our decrease in federal funds sold were the result of a decrease in funds sold on the American Financial Exchange and an increase in interest bearing deposits during the first quarter of 2019.

Investment Securities

Debt securities available for sale totaled \$631.7 million at March 31, 2019 and \$590.2 million at December 31, 2018. Investment securities held to maturity totaled \$0.3 million at March 31, 2019. We had pay downs of \$13.0 million on mortgage-backed securities and calls and maturities of \$10.0 million on municipal securities during the first three months of 2019. We bought \$28.8 million of corporate bonds and \$34.8 million of mortgage-backed securities during the first three months of 2019.

The objective of our investment policy is to invest funds not otherwise needed to meet our loan demand to earn the maximum return, yet still maintain sufficient liquidity to meet fluctuations in our loan demand and deposit structure. In doing so, we seek to balance the market and credit risks against the potential investment return, make investments compatible with the pledge requirements of any deposits of public funds, maintain compliance with regulatory investment requirements, and assist certain public entities with their financial needs. The investment committee has full authority over the investment portfolio and makes decisions on purchases and sales of securities. The entire portfolio, along with all investment transactions occurring since the previous board of directors meeting, is reviewed by the board at each monthly meeting. The investment policy allows portfolio holdings to include short-term securities purchased to provide us with needed liquidity and longer term securities purchased to generate level income for us over periods of interest rate fluctuations.

Each quarter, management assesses whether there have been events or economic circumstances indicating that a security on which there is an unrealized loss is other-than-temporarily impaired. Management considers several factors, including the amount and duration of the impairment; the intent and ability of the Company to hold the security for a period sufficient for a recovery in value; and known recent events specific to the issuer or its industry. In analyzing an issuer's financial condition, management considers whether the securities are issued by agencies of the federal government, whether downgrades by bond rating agencies have occurred, and industry analysts' reports, among other things. As we currently do not have the intent to sell these securities and it is not more likely than not that we will be required to sell these securities before recovery of their amortized cost basis, which may be at maturity, no declines are deemed to be other-than-temporary. We will continue to evaluate our investment securities for possible other-than-temporary impairment, which could result in non-cash charges to earnings in one or more future periods. All securities held are traded in liquid markets.

The Company does not invest in collateralized debt obligations ("CDOs"). We have \$131.8 million of bank holding company subordinated notes. All such bonds were rated BBB or better by Kroll Bond Rating Agency at the time of our investment in them. All other corporate bonds had a Standard and Poor's or Moody's rating of A-1 or better when purchased. The total investment portfolio as of March 31, 2019 has a combined average credit rating of AA.

The carrying value of investment securities pledged to secure public funds on deposit and for other purposes as required by law was \$314.4 million and \$291.6 million as of March 31, 2019 and December 31, 2018, respectively.

Loans

We had total loans of \$6.66 billion at March 31, 2019, up \$126.4 million, or 1.9%, compared to \$6.53 billion at December 31, 2018. At March 31, 2019, the percentage of our total loans in each of our markets was as follows:

| | Percentage of Total Loans in MSA |
|--|--|
| Birmingham-Hoover, AL MSA | 40.1 % |
| Huntsville, AL MSA | 9.1 % |
| Dothan, AL MSA | 9.6 % |
| Montgomery, AL MSA | 6.0 % |
| Mobile, AL MSA | 6.9 % |
| Total Alabama MSAs | 71.7 % |
| Pensacola-Ferry Pass-Brent, FL MSA | 6.2 % |
| Tampa-St. Petersburg-Clearwater, FL MSA | 3.1 % |
| Total Florida MSAs | 9.3 % |
| Atlanta-Sandy Springs-Roswell, GA MSA | 5.4 % |
| Nashville-Davidson-Murfreesboro-Franklin, TN MSA | 9.9 % |
| Charleston-North Charleston, SC MSA | 3.7 % |

Asset Quality

The allowance for loan losses is established and maintained at levels management deems adequate to absorb anticipated credit losses from identified and otherwise inherent risks in the loan portfolio as of the balance sheet date. In assessing the adequacy of the allowance for loan losses, management considers its evaluation of the loan portfolio, past due loan experience, collateral values, current economic conditions and other factors considered necessary to maintain the allowance at an adequate level. Our management believes that the allowance was adequate at March 31, 2019.

The following table presents the allocation of the allowance for loan losses for each respective loan category with the corresponding percentage of loans in each category to total loans. Management believes that the comprehensive allowance analysis developed by our credit administration group is in compliance with all current regulatory guidelines.

| March 31, 2019 | Amount (In Thousands) | Percentage of loans in each category to total loans |
|--|--------------------------|---|
| Commercial, financial and agricultural | \$39,459 | 37.87 % |
| Real estate - construction | 3,595 | 8.35 % |
| Real estate - mortgage | 26,711 | 52.92 % |
| Consumer | 442 | 0.86 % |
| Total | \$70,207 | 100.00 % |

| December 31, 2018 | Amount (In Thousands) | Percentage of loans in each category to total loans |
|--|--------------------------|---|
| Commercial, financial and agricultural | \$39,016 | 38.47 % |
| Real estate - construction | 3,522 | 8.16 % |
| Real estate - mortgage | 25,508 | 52.38 % |
| Consumer | 554 | 0.99 % |
| Total | \$68,600 | 100.00 % |

Nonperforming Assets

Total nonperforming loans, which include nonaccrual loans and loans 90 or more days past due and still accruing, decreased to \$27.2 million at March 31, 2019 compared to \$27.7 million at December 31, 2018. Of this total, nonaccrual loans of \$22.2 million at March 31, 2019 represented a net increase of \$0.3 million from nonaccrual loans at December 31, 2018. Excluding credit card accounts, there was one loan 90 or more days past due and still accruing totaling \$5.0 million at March 31, 2019, compared to three loans totaling \$5.7 million at December 31, 2018. Troubled Debt Restructurings (“TDR”) at March 31, 2019 and December 31, 2018 were \$12.3 million and \$14.6 million, respectively. There were no loans newly classified as a TDR or renewals of existing TDRs for the three months ended March 31, 2019 or 2018.

OREO and repossessed assets increased to \$5.5 million at March 31, 2019, from \$5.2 million at December 31, 2018. The following table summarizes OREO and repossessed asset activity for the three months ended March 31, 2019 and 2018:

| | Three months ended March 31, | |
|---|---------------------------------|---------|
| | 2019 | 2018 |
| | (In thousands) | |
| Balance at beginning of period | \$5,169 | \$6,701 |
| Transfers from loans and capitalized expenses | 381 | 175 |
| Proceeds from sales | (48) | (874) |
| Write-downs / net gain (loss) on sales | (22) | (254) |
| Balance at end of period | \$5,480 | \$5,748 |

The following table summarizes our nonperforming assets and TDRs at March 31, 2019 and December 31, 2018:

| | March 31, 2019 | | December 31, 2018 | |
|---|-------------------------------|-----------------|-------------------|-----------------|
| | Balance | Number of Loans | Balance | Number of Loans |
| | (Dollar Amounts In Thousands) | | | |
| Nonaccrual loans: | | | | |
| Commercial, financial and agricultural | \$11,486 | 28 | \$10,503 | 16 |
| Real estate - construction | 238 | 1 | 997 | 1 |
| Real estate - mortgage: | | | | |
| Owner-occupied commercial | 3,558 | 3 | 3,358 | 2 |
| 1-4 family mortgage | 1,850 | 8 | 2,046 | 9 |
| Other mortgage | 5,022 | 1 | 5,022 | 1 |
| Total real estate - mortgage | 10,430 | 12 | 10,426 | 12 |
| Consumer | — | 1 | — | 1 |
| Total Nonaccrual loans: | \$22,154 | 42 | \$21,926 | 30 |
| 90+ days past due and accruing: | | | | |
| Commercial, financial and agricultural | \$31 | 2 | \$605 | 10 |
| Real estate - construction | — | — | — | — |
| Real estate - mortgage: | | | | |
| Owner-occupied commercial | — | — | — | — |
| 1-4 family mortgage | — | — | 123 | 1 |
| Other mortgage | 4,978 | 1 | 5,008 | 1 |
| Total real estate - mortgage | 4,978 | 1 | 5,131 | 2 |
| Consumer | 12 | 1 | 108 | 28 |
| Total 90+ days past due and accruing: | \$5,021 | 4 | \$5,844 | 40 |
| Total Nonperforming Loans: | \$27,175 | 46 | \$27,770 | 70 |
| Plus: Other real estate owned and repossessions | 5,480 | 11 | 5,169 | 12 |
| Total Nonperforming Assets | \$32,655 | 57 | \$32,939 | 82 |
| Restructured accruing loans: | | | | |
| Commercial, financial and agricultural | \$2,742 | 1 | \$3,073 | 3 |
| Real estate - construction | — | — | — | — |
| Real estate - mortgage: | | | | |
| Owner-occupied commercial | — | — | — | — |
| 1-4 family mortgage | — | — | — | — |
| Other mortgage | — | — | — | — |
| Total real estate - mortgage | — | — | — | — |
| Consumer | — | — | — | — |
| Total restructured accruing loans: | \$2,742 | 1 | \$3,073 | 3 |

Edgar Filing: ServisFirst Bancshares, Inc. - Form 10-Q

| | | | | |
|---|----------|----|----------|----|
| Total Nonperforming assets and restructured accruing loans | \$35,397 | 58 | \$36,012 | 85 |
| Ratios: | | | | |
| Nonperforming loans to total loans | 0.41 | % | 0.43 | % |
| Nonperforming assets to total loans plus other real estate owned and repossessions | 0.49 | % | 0.50 | % |
| Nonperforming assets plus restructured accruing loans to total loans plus other real estate owned and repossessions | 0.53 | % | 0.55 | % |

The balance of nonperforming assets can fluctuate due to changes in economic conditions. We have established a policy to discontinue accruing interest on a loan (i.e., place the loan on nonaccrual status) after it has become 90 days delinquent as to payment of principal or interest, unless the loan is considered to be well-collateralized and is actively in the process of collection. In addition, a loan will be placed on nonaccrual status before it becomes 90 days delinquent unless management believes that the collection of interest is expected. Interest previously accrued but uncollected on such loans is reversed and charged against current income when the receivable is determined to be uncollectible. Interest income on nonaccrual loans is recognized only as received. If we believe that a loan will not be collected in full, we will increase the allowance for loan losses to reflect management's estimate of any potential exposure or loss. Generally, payments received on nonaccrual loans are applied directly to principal.

Impaired Loans and Allowance for Loan Losses

As of March 31, 2019, we had impaired loans of \$36.8 million inclusive of nonaccrual loans, a decrease of \$1.8 million from \$38.6 million as of December 31, 2018. We allocated \$7.3 million of our allowance for loan losses at March 31, 2019 to these impaired loans, a decrease of \$0.8 million compared to \$8.1 million as of December 31, 2018. A loan is considered impaired, based on current information and events, if it is probable that we will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the original loan agreement. Impairment does not always indicate credit loss, but provides an indication of collateral exposure based on prevailing market conditions and third-party valuations. Impaired loans are measured by either the present value of expected future cash flows discounted at the interest rate implicit in the original loan agreement, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral-dependent. The amount of impairment, if any, and subsequent changes are included in the allowance for loan losses. Interest on accruing impaired loans is recognized as long as such loans do not meet the criteria for nonaccrual status. Our credit risk management team performs verification and testing to ensure appropriate identification of impaired loans and that proper reserves are held on these loans.

Of the \$36.8 million of impaired loans reported as of March 31, 2019, \$18.2 million were commercial, financial and agricultural loans, \$0.7 million were real estate – construction loans, \$17.9 million were real estate - mortgage loans and \$49,000 were consumer loans.

Deposits

Total deposits increased by \$168.0 million to \$0.37 billion at March 31, 2019 compared to \$0.29 billion at December 31, 2018. We anticipate long-term sustainable growth in deposits through continued development of market share in our less mature markets and through organic growth in our mature markets.

For amounts and rates of our deposits by category, see the table “Average Consolidated Balance Sheets and Net Interest Analysis on a Fully Taxable-equivalent Basis” under the subheading “Net Interest Income” below.

Borrowings

Our borrowings consist of federal funds purchased and subordinated notes payable. We had \$373.4 million and \$288.7 million at March 31, 2019 and December 31, 2018, respectively, in federal funds purchased from correspondent banks

that are clients of our correspondent banking unit. The average rate paid on these borrowings was 2.59% for the quarter ended March 31, 2019. Other borrowings consist of the following:

\$34.78 million of 5% Subordinated Notes due July 15, 2025, which were issued in a private placement in July 2015 and pay interest semi-annually; and
\$30.0 million of 4.5% Subordinated Notes due November 8, 2027, which were issued in a private placement in November 2017 and pay interest semi-annually.

Liquidity

Liquidity is defined as our ability to generate sufficient cash to fund current loan demand, deposit withdrawals, and other cash demands and disbursement needs, and otherwise to operate on an ongoing basis.

The retention of existing deposits and attraction of new deposit sources through new and existing customers is critical to our liquidity position. If our liquidity was to decline due to a run-off in deposits, we have procedures that provide for certain actions under varying liquidity conditions. These actions include borrowing from existing correspondent banks, selling or participating loans, and curtailing loan commitments and funding. At March 31, 2019, liquid assets, which are represented by cash and due from banks, federal funds sold and unpledged available-for-sale securities, totaled \$1.2 billion. Additionally, the Bank had borrowing availability of approximately \$567.0 million in unused federal funds lines of credit with regional banks, subject to certain restrictions and collateral requirements. We believe these sources of funding are adequate to meet immediate anticipated funding needs, but we may need additional funding if we are able to maintain our current growth rate into the future. Our management meets on a quarterly basis to review sources and uses of funding to determine the appropriate strategy to ensure an appropriate level of liquidity. At the current time, our long-term liquidity needs primarily relate to funds required to support loan originations and commitments and deposit withdrawals. Our regular sources of funding are from the growth of our deposit base, repayment of principal and interest on loans, the sale of loans and the renewal of time deposits. In addition, we have issued debt as described above under "Borrowings."

We are subject to general FDIC guidelines that require a minimum level of liquidity. Management believes our liquidity ratios meet or exceed these guidelines. Our management is not currently aware of any trends or demands that are reasonably likely to result in liquidity materially increasing or decreasing.

The following table reflects the contractual maturities of our term liabilities as of March 31, 2019. The amounts shown do not reflect any early withdrawal or prepayment assumptions.

| | Payments due by Period | | | | |
|------------------------------------|------------------------|------------------|------------------|-----------------|-----------------|
| | Total | 1 year or less | 1 - 3 years | 3 - 5 years | Over 5 years |
| | (In Thousands) | | | | |
| Contractual Obligations (1) | | | | | |
| Deposits without a stated maturity | \$6,403,745 | \$- | \$- | \$- | \$- |
| Certificates of deposit (2) | 679,921 | 399,659 | 184,994 | 95,268 | - |
| Federal funds purchased | 373,378 | 373,378 | - | - | - |
| Subordinated notes payable | 64,750 | - | - | - | 64,750 |
| Operating lease commitments | 16,316 | 3,195 | 5,445 | 4,285 | 3,391 |
| Total | \$7,538,110 | \$776,232 | \$190,439 | \$99,553 | \$68,141 |

(1) Excludes interest.

(2) Certificates of deposit give customers the right to early withdrawal. Early withdrawals may be subject to penalties. The penalty amount depends on the remaining time to maturity at the time of early withdrawal.

Capital Adequacy

As of March 31, 2019, our most recent notification from the FDIC categorized us as well-capitalized under the regulatory framework for prompt corrective action. To remain categorized as well-capitalized, we must maintain minimum common equity Tier 1, Tier 1 risk-based, total risk-based, and Tier 1 leverage ratios as disclosed in the table below. Our management believes that we are well-capitalized under the prompt corrective action provisions as of March 31, 2019.

The following table sets forth (i) the capital ratios required by the FDIC and the Alabama Banking Department's leverage ratio requirement and (ii) our actual ratios of capital to total regulatory or risk-weighted assets, as of March 31, 2019, December 31, 2018 and March 31, 2018:

Edgar Filing: ServisFirst Bancshares, Inc. - Form 10-Q

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|-----------|---------|-------------------------------|--------|--|---------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of March 31, 2019: | | | | | | |
| CET 1 Capital to Risk Weighted Assets: | | | | | | |
| Consolidated | \$731,864 | 10.30 % | \$319,875 | 4.50 % | N/A | N/A |
| ServisFirst Bank | 796,506 | 11.21 % | 319,851 | 4.50 % | \$462,007 | 6.50 % |
| Tier 1 Capital to Risk Weighted Assets: | | | | | | |
| Consolidated | 732,366 | 10.30 % | 426,500 | 6.00 % | N/A | N/A |
| ServisFirst Bank | 797,008 | 11.21 % | 426,468 | 6.00 % | 568,624 | 8.00 % |
| Total Capital to Risk Weighted Assets: | | | | | | |
| Consolidated | 867,748 | 12.21 % | 568,667 | 8.00 % | N/A | N/A |
| ServisFirst Bank | 838,216 | 12.21 % | 568,624 | 8.00 % | 710,780 | 10.00 % |
| Tier 1 Capital to Average Assets: | | | | | | |
| Consolidated | 732,366 | 9.03 % | 324,553 | 4.00 % | N/A | N/A |
| ServisFirst Bank | 797,008 | 9.82 % | 324,537 | 4.00 % | 405,671 | 5.00 % |
| As of December 31, 2018: | | | | | | |
| CET 1 Capital to Risk Weighted Assets: | | | | | | |
| Consolidated | \$705,203 | 10.12 % | \$313,564 | 4.50 % | N/A | N/A |
| ServisFirst Bank | 768,614 | 11.03 % | 313,554 | 4.50 % | \$452,911 | 6.50 % |
| Tier 1 Capital to Risk Weighted Assets: | | | | | | |
| Consolidated | 705,705 | 10.13 % | 418,086 | 6.00 % | N/A | N/A |
| ServisFirst Bank | 769,116 | 11.04 % | 418,071 | 6.00 % | 557,428 | 8.00 % |
| Total Capital to Risk Weighted Assets: | | | | | | |
| Consolidated | 839,471 | 12.05 % | 557,448 | 8.00 % | N/A | N/A |
| ServisFirst Bank | 867,715 | 12.03 % | 557,428 | 8.00 % | 696,786 | 10.00 % |
| Tier 1 Capital to Average Assets: | | | | | | |
| Consolidated | 705,705 | 9.07 % | 311,214 | 4.00 % | N/A | N/A |
| ServisFirst Bank | 769,116 | 9.89 % | 311,206 | 4.00 % | 389,007 | 5.00 % |
| As of March 31, 2018: | | | | | | |
| CET 1 Capital to Risk Weighted Assets: | | | | | | |
| Consolidated | \$619,494 | 9.88 % | \$246,744 | 4.50 % | N/A | N/A |
| ServisFirst Bank | 683,126 | 10.89 % | 246,695 | 4.50 % | \$356,338 | 6.50 % |
| Tier 1 Capital to Risk Weighted Assets: | | | | | | |
| Consolidated | 619,996 | 9.88 % | 328,992 | 6.00 % | N/A | N/A |
| ServisFirst Bank | 683,628 | 10.90 % | 328,927 | 6.00 % | 438,570 | 8.00 % |
| Total Capital to Risk Weighted Assets: | | | | | | |
| Consolidated | 747,185 | 11.91 % | 438,656 | 8.00 % | N/A | N/A |
| ServisFirst Bank | 746,178 | 11.90 % | 438,570 | 8.00 % | 548,212 | 10.00 % |
| Tier 1 Capital to Average Assets: | | | | | | |
| Consolidated | 619,996 | 8.95 % | 250,867 | 4.00 % | N/A | N/A |
| ServisFirst Bank | 683,628 | 9.87 % | 250,848 | 4.00 % | 313,560 | 5.00 % |

Off-Balance Sheet Arrangements

In the normal course of business, we are a party to financial instruments with off-balance sheet risk to meet the financing needs of our customers. These financial instruments include commitments to extend credit beyond current fundings, credit card arrangements, standby letters of credit, and financial guarantees. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in our balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement we have in those particular financial instruments.

Our exposure to credit loss in the event of non-performance by the other party to such financial instruments is represented by the contractual or notional amount of those instruments. We use the same credit policies in making commitments and conditional obligations as we do for on-balance sheet instruments. As of March 31, 2019, we had reserves of \$0.5 million for losses on such off-balance sheet arrangements consistent with guidance in the Federal Reserve Bank's Interagency Policy Statement SR 06-17.

As part of our mortgage operations, we originate and sell certain loans to investors in the secondary market. We continue to experience a manageable level of investor repurchase demands. For loans sold, we have an obligation to either repurchase the outstanding principal balance of a loan or make the purchaser whole for the economic benefits of a loan if it is determined that the loans sold were in violation of representations and warranties made by the Bank at the time of the sale. Representations and warranties typically include those made regarding loans that had missing or insufficient file documentation or loans obtained through fraud by borrowers or other third parties such as appraisers. We had a reserve of \$0.4 million as of March 31, 2019 and December 31, 2018 for the settlement of any repurchase demands by investors.

Financial instruments whose contract amounts represent credit risk at March 31, 2019 are as follows:

| | |
|------------------------------|--|
| | March 31, 2019 (In Thousands) |
| Commitments to extend credit | \$2,013,406 |
| Credit card arrangements | 210,543 |
| Standby letters of credit | 51,787 |
| | \$2,275,736 |

Commitments to extend credit beyond current funded amounts are agreements to lend to a customer as long as there is no violation of any condition established in the applicable loan agreement. Such commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. We evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by us upon extension of credit is based on our management's credit evaluation. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by us to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. All letters of credit are due within one year or less of the original commitment date. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

Results of Operations

Summary of Net Income

Net income and net income available to common stockholders for the three months ended March 31, 2019 was \$35.0 million compared to \$32.6 million for the three months ended March 31, 2018. The increase in net income was primarily attributable to a \$5.6 million increase in net interest income as a result of growth in average earning assets and a \$0.5 million increase in non-interest income, offset by a \$2.2 million increase in non-interest expense and a \$1.4 million increase in provision for income taxes.

Basic and diluted net income per common share were \$0.65 for the three months ended March 31, 2019, compared to \$0.61 and \$0.60, respectively, for the corresponding period in 2018. Return on average assets for the three months ended March 31, 2019 was 1.75% compared to 1.91% for the corresponding period in 2018, and return on average stockholders' equity for the three months ended March 31, 2019 was 19.42% compared to 21.40% for the corresponding period in 2018.

Net Interest Income

Net interest income is the difference between the income earned on interest-earning assets and interest paid on interest-bearing liabilities used to support such assets. The major factors which affect net interest income are changes in volumes, the yield on interest-earning assets and the cost of interest-bearing liabilities. Our management's ability to respond to changes in interest rates by effective asset-liability management techniques is critical to maintaining the stability of the net interest margin and the momentum of our primary source of earnings.

Taxable-equivalent net interest income increased \$6.2 million, or 9.9%, to \$68.8 million for the three months ended March 31, 2019 compared to \$62.6 million for the corresponding period in 2018. This increase was primarily attributable to a \$1.2 billion increase in average earning assets, or 17.5%, year over year. The taxable-equivalent yield on interest-earning assets increased from 4.51% to 4.85% year over year. The yield on loans for the three months ended March 31, 2019 was 5.25% compared to 4.80% for the corresponding period in 2018. The cost of total interest-bearing liabilities increased to 1.73% for the three months ended March 31, 2019 from 0.95% for the corresponding period in 2018. Net interest margin for the three months ended March 31, 2019 decreased 25 basis points to 3.56% from 3.81% for the corresponding period in 2018.

The following table shows, for the three months ended March 31, 2019 and March 31, 2018, the average balances of each principal category of our assets, liabilities and stockholders' equity, and an analysis of net interest revenue. The accompanying table reflects changes in our net interest margin as a result of changes in the volume and rate of our interest-earning assets and interest-bearing liabilities for the same periods. Changes as a result of mix or the number of days in the periods have been allocated to the volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each. Both tables are presented on a taxable-equivalent basis where applicable:

Average Consolidated Balance Sheets and Net Interest Analysis

On a Fully Taxable-Equivalent Basis

For the Three Months Ended March 31,

(Dollar Amounts In Thousands)

| | 2019 | | | 2018 | | |
|--|--------------------|------------------------------|----------------------------|--------------------|------------------------------|----------------------------|
| | Average Balance | Interest Earned / Paid | Average Yield / Rate | Average Balance | Interest Earned / Paid | Average Yield / Rate |
| Assets: | | | | | | |
| Interest-earning assets: | | | | | | |
| Loans, net of unearned income (1) (2) | | | | | | |
| Taxable | \$6,570,920 | \$85,233 | 5.26 % | \$5,847,443 | \$69,321 | 4.81 % |
| Tax-exempt (3) | 30,577 | 287 | 3.81 | 36,357 | 364 | 4.06 |
| Total loans, net of unearned income | 6,601,497 | 85,520 | 5.25 | 5,883,800 | 69,685 | 4.80 |
| Mortgage loans held for sale | 1,614 | 26 | 6.53 | 3,698 | 41 | 4.50 |
| Investment securities: | | | | | | |
| Taxable | 518,955 | 3,746 | 2.89 | 435,747 | 2,745 | 2.52 |
| Tax-exempt (3) | 87,537 | 464 | 2.12 | 120,270 | 770 | 2.56 |
| Total investment securities (4) | 606,492 | 4,210 | 2.78 | 556,017 | 3,515 | 2.53 |
| Federal funds sold | 192,690 | 1,219 | 2.57 | 131,472 | 551 | 1.70 |
| Interest-bearing balances with banks | 438,099 | 2,764 | 2.56 | 96,012 | 383 | 1.62 |
| Total interest-earning assets | \$7,840,392 | \$93,739 | 4.85 % | \$6,670,999 | \$74,175 | 4.51 % |
| Non-interest-earning assets: | | | | | | |
| Cash and due from banks | 74,430 | | | 68,309 | | |
| Net premises and equipment | 58,852 | | | 59,709 | | |
| Allowance for loan losses, accrued interest and other assets | 149,941 | | | 141,588 | | |
| Total assets | \$8,123,615 | | | \$6,940,605 | | |

Liabilities and stockholders' equity:

Interest-bearing liabilities:

Edgar Filing: ServisFirst Bancshares, Inc. - Form 10-Q

| | | | | | | |
|--|-------------|----------|--------|-------------|----------|--------|
| Interest-bearing demand deposits | \$942,686 | \$2,003 | 0.86 % | \$899,311 | \$1,143 | 0.52 % |
| Savings deposits | 54,086 | 73 | 0.55 | 53,269 | 41 | 0.31 |
| Money market accounts | 3,758,162 | 16,513 | 1.78 | 3,027,176 | 6,711 | 0.90 |
| Time deposits | 698,976 | 3,556 | 2.06 | 576,857 | 1,726 | 1.21 |
| Total interest-bearing deposits | 5,453,910 | 22,145 | 1.65 | 4,556,613 | 9,621 | 0.86 |
| Federal funds purchased | 312,989 | 1,995 | 2.59 | 297,051 | 1,171 | 1.60 |
| Other borrowings | 64,671 | 781 | 4.90 | 64,805 | 781 | 4.89 |
| Total interest-bearing liabilities | \$5,831,570 | \$24,921 | 1.73 % | \$4,918,469 | \$11,573 | 0.95 % |
| Non-interest-bearing liabilities: | | | | | | |
| Non-interest-bearing demand deposits | 1,524,502 | | | 1,389,217 | | |
| Other liabilities | 36,362 | | | 15,007 | | |
| Stockholders' equity | 735,611 | | | 621,004 | | |
| Accumulated other comprehensive loss | (4,430) | | | (3,092) | | |
| Total liabilities and stockholders' equity | \$8,123,615 | | | \$6,940,605 | | |
| Net interest income | | \$68,818 | | | \$62,602 | |
| Net interest spread | | | 3.12 % | | | 3.56 % |
| Net interest margin | | | 3.56 % | | | 3.81 % |

(1) Non-accrual loans are included in average loan balances in all periods. Loan fees of \$973 and \$749 are included in interest income in the first quarter of 2019 and 2018, respectively.

(2) Net accretion on acquired loan discounts of \$84 and \$68 are included in interest income in the first quarter of 2019 and 2018, respectively..

(3) Interest income and yields are presented on a fully taxable equivalent basis using a tax rate of 21%.

(4) Unrealized losses of \$5,664 and \$3,963 are excluded from the yield calculation in the first quarter of 2019 and 2018, respectively.

| | For the Three Months Ended March 31, 2019 Compared to 2018 Increase (Decrease) in Interest Income and Expense Due to Changes in: | | |
|--------------------------------------|---|------------|----------|
| | Volume | Rate | Total |
| | (In Thousands) | | |
| Interest-earning assets: | | | |
| Loans, net of unearned income | | | |
| Taxable | \$8,128 | \$7,784 | \$15,912 |
| Tax-exempt | (61) | (16) | (77) |
| Total loans, net of unearned income | 8,067 | 7,768 | 15,835 |
| Mortgages held for sale | (29) | 14 | (15) |
| Debt securities: | | | |
| Taxable | 528 | 473 | 1,001 |
| Tax-exempt | (195) | (111) | (306) |
| Total debt securities | 333 | 362 | 695 |
| Federal funds sold | 308 | 360 | 668 |
| Interest-bearing balances with banks | 2,030 | 351 | 2,381 |
| Total interest-earning assets | 10,709 | 8,855 | 19,564 |
| Interest-bearing liabilities: | | | |
| Interest-bearing demand deposits | 55 | 805 | 860 |
| Savings | 1 | 31 | 32 |
| Money market accounts | 1,867 | 7,935 | 9,802 |
| Time deposits | 408 | 1,422 | 1,830 |
| Total interest-bearing deposits | 2,331 | 10,193 | 12,524 |
| Federal funds purchased | 62 | 762 | 824 |
| Other borrowed funds | (4) | 4 | — |
| Total interest-bearing liabilities | 2,389 | 10,959 | 13,348 |
| Increase in net interest income | \$8,320 | \$(2,104) | \$6,216 |

Our growth in loans continues to drive favorable volume component change and overall change. The rate component was unfavorable as average rates paid on interest-bearing liabilities increased 78 basis points while loan yields increased 45 basis points. Increased rates and yields were primarily the result of increases in rates by the Federal Reserve Bank during 2018. Growth in non-interest-bearing deposits and equity also contributed to the increase in net interest revenue during the three months ended March 31, 2019 compared to the same period in 2018.

Provision for Loan Losses

The provision for loan losses represents the amount determined by management to be necessary to maintain the allowance for loan losses at a level capable of absorbing inherent losses in the loan portfolio. Our management reviews the adequacy of the allowance for loan losses on a quarterly basis. The allowance for loan losses calculation is segregated into various segments that include classified loans, loans with specific allocations and pass rated loans. A pass rated loan is generally characterized by a very low to average risk of default and in which management perceives there is a minimal risk of loss. Loans are rated using a nine-point risk grade scale with loan officers having the primary responsibility for assigning risk grades and for the timely reporting of changes in the risk grades. Based on these processes, and the assigned risk grades, the criticized and classified loans in the portfolio are segregated into the following regulatory classifications: Special Mention, Substandard, Doubtful or Loss, with some general allocation of reserve based on various internal and external factors. At March 31, 2019, total loans rated Special Mention, Substandard, and Doubtful were \$133.3 million, or 2.0% of total loans, compared to \$139.0 million, or 2.1% of total loans, at December 31, 2018. Impaired loans are reviewed specifically and separately under FASB ASC 310-30-35, Subsequent Measurement of Impaired Loans, to determine the appropriate reserve allocation. Our management compares the investment in an impaired loan with the present value of expected future cash flow discounted at the interest rate implicit in the original loan agreement, the loan's observable market price or the fair value of the collateral, if the loan is collateral-dependent, to determine the specific reserve allowance. Reserve percentages assigned to non-impaired loans are based on historical charge-off experience adjusted for other risk factors. To evaluate the overall adequacy of the allowance to absorb losses inherent in our loan portfolio, our management considers historical loss experience based on volume and types of loans, trends in classifications, volume and trends in delinquencies and nonaccruals, economic conditions and other pertinent information. Based on future evaluations, additional provisions for loan losses may be necessary to maintain the allowance for loan losses at an appropriate level.

The provision for loan losses was \$4.9 million for the three months ended March 31, 2019, an increase of \$0.8 million from \$4.1 million for the three months ended March 31, 2018. Net credit charge-offs to quarter-to-date average loans were 0.20% for the first quarter of 2019, a 10 basis point decrease compared to 0.30% for the fourth quarter of 2018 and a 10 basis point increase compared to 0.10% for the first quarter of 2018. Nonperforming loans decreased to \$27.2 million, or 0.41% of total loans, at March 31, 2019 from \$27.8 million, or 0.43% of total loans, at December 31, 2018, and were higher than \$9.9 million, or 0.17% of total loans, at March 31, 2018. Impaired loans decreased to \$36.8 million, or 0.55% of total loans, at March 31, 2019, compared to \$38.6 million, or 0.59% of total loans, at December 31, 2018. The allowance for loan losses totaled \$70.7 million, or 1.05% of total loans, net of unearned income, at March 31, 2019, compared to \$68.6 million, or 1.05% of loans, net of unearned income, at December 31, 2018.

Noninterest Income

Noninterest income totaled \$4.9 million for the three months ended March 31, 2019, an increase of \$0.5 million compared to the corresponding period in 2018. Service charges on deposit accounts increased \$0.1 million to \$1.7

million during the three months ended March 31, 2019 from \$1.6 million during the corresponding period in 2018. The number of transaction deposit accounts increased 11.7% from March 31, 2018 to March 31, 2019. Credit card income increased \$0.3 million to \$1.6 million during the three months ended March 31, 2019 compared to \$1.3 million during the corresponding period in 2018. Spending on credit cards increased 21% for the same comparative period.

Noninterest Expense

Noninterest expense totaled \$25.3 million for the three months ended March 31, 2019, an increase of \$2.3 million compared to \$23.1 million for the corresponding period in 2018.

Details of expenses are as follows:

Salary and employee benefit expense increased \$1.0 million to \$14.3 million for the three months ended March 31, 2019 from \$13.3 million for the corresponding period in 2018. We had 485 total employees as of March 31, 2019 compared to 437 as of March 31, 2018, a 11% increase.

Equipment and occupancy expense increased \$0.3 million to \$2.3 million for the three months ended March 31, 2019 from \$2.0 million for the corresponding period in 2018.

Professional services increased \$0.2 million to \$1.0 million for the three months ended March 31, 2019 from \$0.8 million for the corresponding period in 2018. Increased audit fees and consulting fees related to compliance projects contributed to this increase in professional services.

FDIC insurance assessments decreased \$0.1 million to \$1.0 million for the three months ended March 31, 2019 from \$1.1 million for the corresponding period in 2018. Decreases in the assessment rates more than offset increases in our net average total assets, which is our assessment base.

Expenses related to other real estate owned decreased to \$22,000 for the three months ended March 31, 2019 from \$0.3 million for the corresponding period in 2018.

Other operating expenses increased \$1.2 million to \$6.8 million for the three months ended March 31, 2019 from \$5.6 million for the corresponding period in 2018. Increases in software expense, data processing, Federal Reserve Bank service charges and insurance contributed to this increase in other operating expenses. Software and data processing expenses were driven by continued implementation costs of new systems in our back-room areas and increases in transaction volumes. Increased service charges continue to be driven by increased volumes of transactions in our correspondent banking division. Our insurance premiums increased due to higher rates.

Changes in our non-interest income and expenses, including percentage changes, are detailed in the following table:

| | Three Months Ended March 31, | | \$ | % |
|---|---------------------------------|----------|--------|---------|
| | 2019 | 2018 | change | change |
| | (Dollars In Thousands) | | | |
| Noninterest income: | | | | |
| Service charges on deposit accounts | \$1,702 | \$1,585 | \$117 | 7.4 % |
| Mortgage banking | 575 | 518 | 57 | 11.0 % |
| Credit card income | 1,576 | 1,255 | 321 | 25.6 % |
| Securities gains (losses) | – | 4 | (4) | NM |
| Increase in cash surrender value life insurance | 762 | 777 | (15) | (1.9)% |
| Other operating income | 327 | 276 | 51 | 18.5 % |
| Total noninterest income | \$4,942 | \$4,415 | \$527 | 11.9 % |
| Noninterest expenses: | | | | |
| Salaries and employee benefits | \$14,265 | \$13,296 | \$969 | 7.3 % |
| Equipment and occupancy expense | 2,259 | 1,954 | 305 | 15.6 % |

Edgar Filing: ServisFirst Bancshares, Inc. - Form 10-Q

| | | | | |
|---------------------------------------|----------|----------|---------|---------|
| Professional services | 994 | 805 | 189 | 23.5 % |
| FDIC and other regulatory assessments | 1,019 | 1,133 | (114) | (10.1)% |
| Other real estate owned expense | 22 | 316 | (294) | (93.0)% |
| Other operating expenses | 6,767 | 5,554 | 1,213 | 21.8 % |
| Total non-interest expenses | \$25,326 | \$23,058 | \$2,268 | 9.8 % |

Income Tax Expense

Income tax expense was \$8.5 million for the three months ended March 31, 2019 versus \$7.1 million for the same period in 2018. Our effective tax rate for the three months ended March 31, 2019 was 19.5%, compared to 17.8% for the corresponding period in 2018. We recognized excess tax benefits as a credit to our income tax expense from the exercise of stock options and vesting of restricted stock of \$0.8 million in the first quarter of 2019, compared to \$1.5 million in the first quarter of 2018. Our primary permanent differences are related to tax-exempt income on securities, state income tax benefit on real estate investment trust dividends, various qualifying tax credits and change in cash surrender value of bank-owned life insurance.

We own real estate investment trusts for the purpose of holding and managing participations in residential mortgages and commercial real estate loans originated by the Bank. The trusts are wholly-owned subsidiaries of a trust holding company, which in turn is an indirect wholly-owned subsidiary of the Bank. The trusts earn interest income on the loans they hold and incur operating expenses related to their activities. They pay their net earnings, in the form of dividends, to the Bank, which receives a deduction for state income taxes.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Like all financial institutions, we are subject to market risk from changes in interest rates. Interest rate risk is inherent in the balance sheet due to the mismatch between the maturities of rate-sensitive assets and rate-sensitive liabilities. If rates are rising, and the level of rate-sensitive liabilities exceeds the level of rate-sensitive assets, the net interest margin will be negatively impacted. Conversely, if rates are falling, and the level of rate-sensitive liabilities is greater than the level of rate-sensitive assets, the impact on the net interest margin will be favorable. Managing interest rate risk is further complicated by the fact that all rates do not change at the same pace; in other words, short-term rates may be rising while longer-term rates remain stable. In addition, different types of rate-sensitive assets and rate-sensitive liabilities react differently to changes in rates.

To manage interest rate risk, we must take a position on the expected future trend of interest rates. Rates may rise, fall or remain the same. Our asset-liability committee (“ALCO”) develops its view of future rate trends and strives to manage rate risk within a targeted range by monitoring economic indicators, examining the views of economists and other experts, and understanding the current risks that our balance sheet is exposed to. Our annual budget reflects the anticipated rate environment for the next 12 months.

The ALCO employs modeling techniques such as net interest income simulations and economic value of equity simulations to determine what amount of the Bank’s net interest income is at risk given different movements in market interest rates. Simulations assume gradual and instantaneous (shocks) movements in market interest rates of up and down 100, 200, 300 and 400 basis points. A set of Benchmark and optional scenarios are ran and results are compared to base model results to measure sensitivity to movements in market interest rates. The ALCO establishes limits for the amount of negative change in net interest margin in the first year, second year and two-year cumulative time horizon. Current policy limits for the 100 basis point scenario in the first and second year is -5% and for the two-year cumulative is -10%. Current policy limits for the 200 basis point scenario in the first and second year is -10% and for the two-year cumulative is -15%. The ALCO conducts a quarterly analysis of the rate sensitivity position, reviews established limits, and reports its results to our board of directors. There have been no significant changes to our sensitivity to changes in interest rates since December 31, 2018.

ITEM 4. CONTROLS AND PROCEDURES

CEO and CFO Certification.

Appearing as exhibits to this report are Certifications of our Chief Executive Officer (“CEO”) and our Chief Financial Officer (“CFO”). The Certifications are required to be made by Rule 13a-14 under the Securities Exchange Act of 1934,

as amended (the “Exchange Act”). This item contains the information about the evaluation that is referred to in the Certifications, and the information set forth below in this Item 4 should be read in conjunction with the Certifications for a more complete understanding of the Certifications.

Evaluation of Disclosure Controls and Procedures.

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

We conducted an evaluation (the “Evaluation”) of the effectiveness of the design and operation of our disclosure controls and procedures under the supervision and with the participation of our management, including our CEO and CFO, as of March 31, 2019. Based upon the Evaluation, our CEO and CFO have concluded that, as of March 31, 2019, our disclosure controls and procedures are effective to ensure that material information relating to ServisFirst Bancshares, Inc. and its subsidiaries is made known to management, including the CEO and CFO, particularly during the period when our periodic reports are being prepared.

There have not been any changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time we may be a party to various legal proceedings arising in the ordinary course of business. Management does not believe the Company or the Bank is currently a party to any material legal proceedings except as disclosed in Item 3, “Legal Proceedings”, in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018, and there has been no material change in any matter described therein.

ITEM 1A. RISK FACTORS

Our business is influenced by many factors that are difficult to predict, involve uncertainties that may materially affect actual results and are often beyond our control. We have identified a number of these risk factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018, which should be taken into consideration when reviewing the information contained in this report. There have been no material changes with regard to the risk factors previously disclosed in the Form 10-K. For other factors that may cause actual results to differ materially from those indicated in any forward-looking statement or projection contained in this report, see “Forward-Looking Statements” under Part 1, Item 2 above.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

(a) Exhibit:

- 10.1* Third Amendment to the ServisFirst Bancshares, Inc. Amended and Restated 2009 Stock Incentive Plan
- 10.2* Form of Nonqualified Stock Option Award Pursuant to the ServisFirst Bancshares, Inc. Amended and Restated 2009 Stock Incentive Plan (Revised 2019)
- 10.3* Form of ServisFirst Bancshares, Inc. Amended and Restated 2009 Stock Incentive Plan Restricted Stock Award Agreement (Revised 2019)
- 31.01 Certification of principal executive officer pursuant to Rule 13a-14(a).
- 31.02 Certification of principal financial officer pursuant to Rule 13a-14(a).
- 32.01 Certification of principal executive officer pursuant to 18 U.S.C. Section 1350.
- 32.02 Certification of principal financial officer pursuant to 18 U.S.C. Section 1350.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document

*denotes compensatory plan or arrangement

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SERVISFIRST
BANCSHARES, INC.

Date: April 30, 2019 By /s/ Thomas A. Broughton III
Thomas A. Broughton III
President and Chief Executive
Officer

Date: April 30, 2019 By /s/ William M. Foshee
William M. Foshee
Chief Financial Officer