SYSCO CORP
Form 4
July 11, 2014

FORM 4

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

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

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL
OMB Number: 3235-0287
Expires: January 31, 2005
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(Print or Type Responses)

1. Name and Address of Reporting Person *
WARD JACKIE M

(Last) (First) (Middle)

1390 ENCLAVE PARKWAY

(Street)

HOUSTON, TX 77077

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
SYSCO CORP [SYY]

3. Date of Earliest Transaction (Month/Day/Year)
07/09/2014

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director _____ 10% Owner
_____ Officer (give title below) _____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	07/09/2014		A		3,911 (1)	A	$ 36.75	81,543.697	D	
Common Stock	07/09/2014		A		170 (2)	A	$ 36.75	81,713.697	D	
Common Stock								61	I	Spouse

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
WARD JACKIE M 1390 ENCLAVE PARKWAY HOUSTON, TX 77077	X			

Signatures

/s/ Russell T. Libby, attorney-in-fact	07/11/2014
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) Represents shares elected to be received in lieu of non-employee director annual cash retainer fees pursuant to 2009 Non-Employee Directors Stock Plan. The receipt of these shares has been deferred pursuant to the 2009 Board of Directors Stock Deferral Plan.

(2) Represents company match equal to 50% of a portion of the shares described in Footnote 1. The receipt of these shares has been deferred pursuant to the 2009 Board of Directors Stock Deferral Plan.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
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ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth our selected historical consolidated financial data for the periods and as of the dates indicated. You should read this information together with Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our audited consolidated financial statements and the related notes included elsewhere in this Annual Report on Form 10-K. The selected historical consolidated financial data as of and for the years ended December 31, 2018, 2017 and 2016 are derived from our audited consolidated financial statements, which are included elsewhere in this Annual Report on Form 10-K. The selected historical consolidated financial data as of and for the years ended December 31, 2015 and 2014 (except as otherwise noted below) are derived from our audited consolidated financial statements not included in this Annual Report on Form 10-K. Our historical results for any prior period are not necessarily indicative of future performance.

	As of and for the Years Ended December 31,				
	2018(1)	2017	2016(2)	2015(3)	2014
	(Dollars in thousands, except share and per share data)				
Selected Period End Balance Sheet Data:					
Cash and cash equivalents	$268,947	$182,103	$142,098	$148,431	$167,540
Available for sale securities	337,293	309,615	316,455	165,097	84,962
Loans held for sale	—	—	—	27,887	—
Loans held for investment	3,708,306	2,270,876	1,891,635	1,653,165	1,002,054
Allowance for loan losses	26,331	23,649	17,911	13,098	8,246
Goodwill and intangible assets, net	249,712	42,663	43,444	44,619	12,891
Total assets	4,655,249	2,860,231	2,450,948	2,084,579	1,280,008
Noninterest-bearing deposits	1,209,300	683,110	593,751	620,320	373,795
Interest-bearing deposits	2,453,236	1,530,864	1,276,432	1,138,813	759,889
Total deposits	3,662,536	2,213,974	1,870,183	1,759,133	1,133,684
Total shareholders' equity	702,984	306,865	279,817	258,490	131,778
Total tangible shareholders' equity(4)	453,272	264,202	236,373	213,871	118,887
Selected Income Statement Data:					
Net interest income	$128,579	$103,668	$89,864	$80,166	$46,834
Provision for loan losses	4,248	13,188	5,469	5,792	2,150
Net interest income after provision for loan losses	124,331	90,480	84,395	74,374	44,684
Noninterest income	7,713	5,861	7,268	3,992	2,607
Noninterest expense	86,787	69,962	59,258	54,805	33,458
Net income before income taxes	45,257	26,379	32,405	23,561	13,833
Net income	37,309	17,632	22,851	15,786	9,005
Net income attributable to common shareholders(5)	37,309	17,632	22,851	15,227	9,005
Selected Per Share Data:					
Earnings per common share, basic	$2.41	$1.34	$1.78	$1.45	$1.29
Earnings per common share, diluted	2.37	1.31	1.75	1.43	1.26
Book value per common share	32.04	23.20	21.59	20.17	17.62
Tangible book value per common share(4)	20.66	19.97	18.24	16.69	15.90
Weighted average common shares outstanding, basic	15,484,757	13,124,900	12,873,326	10,470,465	6,978,025
Weighted average common shares outstanding, diluted	15,773,039	13,457,718	13,073,932	10,654,003	7,142,377
Shares outstanding at end of period	21,937,740	13,226,826	12,958,341	12,812,985	7,477,309

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	As of and for the Years Ended December 31,				
	2018[1]	2017	2016[2]	2015[3]	2014
	(Dollars in thousands, except share and per share data)				
Selected Performance Metrics:					
Return on average assets[6]	1.11 %	0.65 %	0.98 %	0.81 %	0.75 %
Return on average common equity[6]	9.02 %	5.92 %	8.36 %	7.43 %	7.73 %
Return on average tangible common equity[4][6]	11.20 %	6.93 %	9.96 %	9.52 %	8.70 %
Tax equivalent net interest margin[7]	4.27 %	4.34 %	4.37 %	4.68 %	4.31 %
Efficiency ratio[8]	63.68 %	63.89 %	62.34 %	65.27 %	67.79 %
Loans to deposits ratio	101.25 %	102.57 %	101.15 %	95.56 %	88.39 %
Noninterest expense to average assets	2.58 %	2.59 %	2.53 %	2.83 %	2.80 %
Selected Credit Quality Ratios:					
Nonperforming assets to total assets[9]	0.72 %	0.49 %	0.75 %	0.25 %	0.25 %
Nonperforming loans to total loans[10]	0.89 %	0.59 %	0.88 %	0.31 %	0.32 %
Allowance for loan losses to nonperforming loans[10]	79.90 %	177.44 %	107.26 %	252.66 %	258.98 %
Allowance for loan losses to total loans	0.71 %	1.04 %	0.95 %	0.78 %	0.82 %
Provision for loan losses to average loans	0.16 %	0.63 %	0.31 %	0.38 %	0.23 %
Net charge-offs to average loans	0.06 %	0.36 %	0.04 %	0.06 %	0.06 %
Capital Ratios:					
Common equity Tier 1 capital ratio	11.76 %	10.54 %	11.30 %	11.72 %	N/A
Tier 1 risk-based capital	12.01 %	10.92 %	11.73 %	12.21 %	11.96 %
Total risk-based capital	13.70 %	13.43 %	12.57 %	12.92 %	12.80 %
Leverage capital ratio	10.61 %	9.84 %	10.35 %	11.02 %	9.55 %
Total equity to total assets	15.10 %	10.73 %	11.42 %	12.40 %	10.30 %
Tangible common equity to tangible assets[4]	10.29 %	9.38 %	9.82 %	10.48 %	9.38 %

(1) We completed the acquisition of Post Oak Bancshares, Inc. on October 1, 2018.

(2) We completed the sale of two Central Texas branches acquired from F&M Bancshares during the first quarter of 2016.

(3) We completed the acquisition of F&M Bancshares on January 1, 2015.

(4) This is a non-GAAP financial measure. See our reconciliation of non-GAAP financial measures presented in the foregoing selected financial information to their most directly comparable GAAP financial measures under the caption Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations—GAAP Reconciliation and Management’s Explanation of Non-GAAP Financial Measures.”

(5) On January 1, 2015, we issued shares of Series A and Series B preferred stock, in connection with the acquisition of F&M Bancshares, which had preferred stock outstanding pursuant to the U.S. Treasury’s Troubled Asset Relief Program. We paid $559 thousand in preferred dividends during 2015. On July 15, 2015, we redeemed all of the outstanding shares of Series A and Series B preferred stock with cash on hand for an aggregate redemption price of $11.7 million (which is the sum of the liquidation amount plus accrued and unpaid dividends up to, but excluding, the redemption date).

(6) Except as otherwise indicated in this footnote, we calculate our average assets and average common equity for a period by dividing the sum of total assets or total common shareholders’ equity, as the case may be, as of the close of business on each day in the relevant period, by the number of days in the period. We calculate return on average assets by dividing net income for that period by average assets. We calculate return on average common equity for a period by dividing net income attributable to common shareholders for that period by average common equity and average tangible common equity, as the case may be, for that period.

(7) Net interest margin represents net interest income divided by average interest-earning assets.

(8) Efficiency ratio represents total noninterest expense divided by the sum of net interest income plus noninterest income, excluding net gains and losses on the sale of loans, securities and assets (including the sale of the two acquired Central Texas branches). Additionally, taxes and provision for loan losses are not part of this calculation.

(9) Nonperforming assets include nonaccrual loans, loans past due 90 days or more and still accruing interest, repossessed assets and other real estate.

(10) Nonperforming loans include nonaccrual loans and loans past due 90 days or more and still accruing interest.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with Item 6. "Selected Financial Data" and the Company's consolidated financial statements and the accompanying notes included elsewhere in this Annual Report on Form 10-K. This discussion and analysis contains forward-looking statements that are subject to certain risks and uncertainties and are based on certain assumptions that the Company believes are reasonable but may prove to be inaccurate. Certain risks, uncertainties and other factors, including those set forth under " – Cautionary Notice Regarding Forward-Looking Statements," in this Item 7, under Item 1A. "Risk Factors" and elsewhere in this Annual Report on Form 10-K, may cause actual results to differ materially from those projected results discussed in the forward-looking statements appearing in this discussion and analysis. The Company assumes no obligation to update any of these forward-looking statements.

Cautionary Notice Regarding Forward-Looking Statements

Statements and financial discussion and analysis contained in this Annual Report on Form 10-K that are not historical facts are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. We also may make forward-looking statements in our other documents filed or furnished with the SEC. In addition, our senior management may make forward-looking statements orally to investors, analysts, representatives of the media and others. Statements preceded by, followed by or that otherwise include the words "believes," "expects," "anticipates," "intends," "projects," "estimates," "plans" and similar expressions or future or conditional such as "will," "should," "would," "may" and "could" are generally forward-looking in nature and not historical facts, although not all forward looking statements include the foregoing. Forward-looking statements are based on assumptions and involve a number of risks and uncertainties, many of which are beyond our control. Many possible events or factors could affect our future financial results and performance and could cause such results or performance to differ materially from those expressed in our forward-looking statements.

While there is no assurance that any list of risks and uncertainties or risk factors is complete, below are certain factors which could cause our actual results to differ from those in our forward-looking statements:

- risks related to the concentration of our business in the Houston region, including risks associated with volatility or decreases in oil and gas prices or prolonged periods of lower oil and gas prices;
- general market conditions and economic trends nationally, regionally and particularly in the Houston region;
- our ability to retain executive officers and key employees and their customer and community relationships;
- our ability to recruit and retain successful bankers that meet our expectations in terms of customer and community relationships and profitability;
- risks related to our strategic focus on lending to small to medium-sized businesses;
- our ability to implement our growth strategy, including through the identification of acquisition candidates that will be accretive to our financial condition and results of operations, as well as permitting decision-making authority at the branch level;
- risks related to any businesses we acquire in the future, including exposure to potential asset and credit quality risks and unknown or contingent liabilities, the time and costs associated with integrating systems, technology platforms, procedures and personnel, the need for additional capital to finance such transactions and possible failures in realizing the anticipated benefits from such acquisitions;
- risks associated with our owner-occupied commercial real estate loan and other commercial real estate loan portfolios, including the risks inherent in the valuation of the collateral securing such loans;
- risks associated with our commercial and industrial loan portfolio, including the risk for deterioration in value of the general business assets that generally secure such loans;
- the accuracy and sufficiency of the assumptions and estimates we make in establishing reserves for potential loan losses and other estimates;
-

risk of deteriorating asset quality and higher loan charge-offs, as well as the time and effort necessary to resolve nonperforming assets;

- potential changes in the prices, values and sales volumes of commercial and residential real estate securing our real estate loans;
- risks related to loans originated and serviced under the Small Business Administration's guidelines;
- changes in market interest rates that affect the pricing of our loans and deposits and our net interest income;

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- potential fluctuations in the market value and liquidity of the securities we hold for sale;
- risk of impairment of investment securities, goodwill, other intangible assets or deferred tax assets;
- the effects of competition from a wide variety of local, regional, national and other providers of financial, investment and insurance services, which may adversely affect our pricing and terms;
- risks associated with negative public perception of the Company;
- our ability to maintain an effective system of disclosure controls and procedures and internal controls over financial reporting;
- risks associated with fraudulent and negligent acts by our customers, employees or vendors;
- our ability to keep pace with technological change or difficulties when implementing new technologies;
- risks associated with system failures or failures to protect against cybersecurity threats, such as breaches of our network security;
- our ability to comply with privacy laws and properly safeguard personal, confidential or proprietary information;
- risks associated with data processing system failures and errors;
- potential risk of environmental liability related to owning or foreclosing on real property;
- the institution and outcome of litigation and other legal proceeding against us or to which we become subject;
- our ability to maintain adequate liquidity and to raise necessary capital to fund our acquisition strategy and operations or to meet increased minimum regulatory capital levels;
- our ability to comply with various governmental and regulatory requirements applicable to financial institutions;
- the impact of recent and future legislative and regulatory changes, including changes in banking, securities and tax laws and regulations and their application by our regulators, such as the further implementation of the Dodd-Frank Act;
- governmental monetary and fiscal policies, including the policies of the Federal Reserve;
- our ability to comply with supervisory actions by federal and state banking agencies;
- changes in the scope and cost of FDIC insurance and other coverage;
- systemic risks associated with the soundness of other financial institutions;
- the effects of war or other conflicts, acts of terrorism (including cyberattacks) or other catastrophic events, including storms, droughts, tornadoes and flooding, that may affect general economic conditions; and
- other risks and uncertainties listed from time to time in our reports and documents filed with the SEC.

Further, these forward-looking statements speak only as of the date on which they were made and we undertake no obligation to update or revise any forward-looking statements to reflect events or circumstances after the date on which these statements are made or to reflect the occurrence of unanticipated events, unless required to do so under the federal securities laws. Other factors not identified above, including those described under the heading Item 1A. “Risk Factors” and elsewhere in this Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” may also cause actual results to differ materially from those described in our forward looking statements. Most of these factors are difficult to anticipate and are generally beyond our control. You should consider these factors in connection with considering any forward-looking statements that may be made by us.

Overview

We generate most of our income from interest income on loans, service charges on customer accounts and interest income from investments in securities. We incur interest expense on deposits and other borrowed funds and noninterest expenses such as salaries and employee benefits and occupancy expenses. Net interest income is the difference between interest income on earning assets such as loans and securities and interest expense on liabilities such as deposits and borrowings that are used to fund those assets. Net interest income is our largest source of revenue. To evaluate net interest income, we measure and monitor (1) yields on our loans and other interest-earning assets, (2) the interest expenses of our deposits and other funding sources, (3) our net interest spread and (4) our net interest margin. Net interest spread is the difference between rates earned on interest-earning assets and rates paid on interest-bearing liabilities. Net interest margin is calculated as net interest income divided by average interest-earning assets. Because noninterest-bearing sources of funds, such as noninterest-bearing deposits and shareholders’ equity, also fund interest-earning assets, net interest margin includes the benefit of these noninterest-bearing sources.

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Our net interest income is affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, referred to as a “volume change.” Periodic changes in the volume and types of loans in our loan portfolio are affected by, among other factors, economic and competitive conditions in Texas and specifically in the Houston region, as well as developments affecting the real estate, technology, financial services, insurance, transportation, manufacturing and energy sectors within our target market and throughout the state of Texas.

Our net interest income is also affected by changes in yields earned on interest-earning assets and rates paid on interest-bearing deposits and borrowed funds, referred to as a “rate change.” Fluctuations in market interest rates are driven by many factors, including governmental monetary policies, inflation, deflation, macroeconomic developments, changes in unemployment, the money supply, political and international conditions and conditions in domestic and foreign financial markets.

On October 1, 2018, we completed the acquisition of Post Oak Bancshares, Inc. and its wholly-owned subsidiary bank, Post Oak Bank, N.A. (collectively, “Post Oak”). Because the acquisition closed on October 1, 2018, our results of operations included Post Oak for only a portion of 2018. Our historical financial condition and results of operations as of and for periods ended before December 31, 2018 contained in this Annual Report on Form 10-K do not reflect the financial condition and results of operations of Post Oak. In connection with the acquisition of Post Oak, we issued 8.4 million shares of Company common stock.

In addition to the impact of the acquisition of Post Oak, the comparability of our consolidated results of operations for the year ended December 31, 2014 may be affected by our acquisition of F&M Bancshares on January 1, 2015. The results of the acquired operations of F&M Bancshares were included in our results of operations for 2015, as compared to the full year 2014.

We completed an initial public offering of 2,990,000 shares of Allegiance's common stock at $21.00 per share on October 7, 2015, generating net proceeds of $57.1 million. Allegiance's common stock began trading on the NASDAQ Global Market on October 8, 2015 under the ticker symbol “ABTX.”

Critical Accounting Policies

Certain of our accounting estimates are important to the portrayal of our financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Estimates are susceptible to material changes as a result of changes in facts and circumstances. Facts and circumstances which could affect these judgments include, but are not limited to, changes in interest rates, changes in the performance of the economy and changes in the financial condition of borrowers. Management believes that determining the allowance for loan losses is its most critical accounting estimate. Our accounting policies are discussed in detail in Note 1 – Nature of Operations and Summary of Significant Accounting and Reporting Policies in the accompanying notes to the consolidated financial statements included elsewhere in this Annual Report on Form 10-K.

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance that is established through charges to earnings in the form of a provision for loan losses. The amount of the allowance for loan losses is affected by the following: (1) charge-offs of loans that decrease the allowance, (2) subsequent recoveries on loans previously charged off that increase the allowance and (3) provisions for loan losses charged to income that increase the allowance. Management considers the policies related to the allowance for loan losses as the most critical to the financial statement presentation. The total allowance for loan losses includes activity related to allowances calculated in accordance with Accounting Standards Codification (“ASC”) 310, Receivables, and ASC 450, Contingencies.

Throughout the year, management estimates the probable incurred losses in the loan portfolio to determine if the allowance for loan losses is adequate to absorb such losses. The allowance for loan losses consists of specific and general components. The specific component relates to loans that are individually classified as impaired. We follow a loan review program to evaluate the credit risk in the loan portfolio. Loans that have been identified as impaired are reviewed on a quarterly basis in order to determine whether a specific reserve is required. The general component covers non-impaired loans and is based on industry and our specific historical loan loss experience, volume, growth and composition of the loan portfolio, the evaluation of our loan portfolio through our internal loan review process, general current economic conditions both internal and external to us that may affect the borrower's ability to pay, value of collateral and other qualitative relevant risk factors. Based on a review of these estimates, we adjust the allowance for loan losses to a level determined by management to be adequate. Estimates of loan losses are inherently subjective as they involve an exercise of judgment.

Loans acquired in business combinations are initially recorded at fair value, which includes an estimate of loan losses expected to be realized over the remaining lives of the loans. Therefore, no corresponding allowance for loan losses is recorded for these loans at acquisition. Methods utilized to estimate any subsequently required allowance for loan losses for acquired loans not deemed credit-impaired at acquisition are similar to originated loans. However, the estimate of loss is based on the unpaid principal balance and then compared to any remaining unaccreted purchase discount. To the extent that the calculated loss is greater than the remaining unaccreted purchase discount, an allowance is recorded for such difference.

Emerging Growth Company

Pursuant to the JOBS Act, an emerging growth company can elect to opt in to any new or revised accounting standards that may be issued by the FASB or the SEC otherwise applicable to non-emerging growth companies. We have elected to opt in to such standards, which election is irrevocable.

We will likely continue to take advantage of some of the reduced regulatory and reporting requirements that are available to us so long as we qualify as an emerging growth company, including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404(b) of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation and exemptions from the requirements of holding non-binding advisory votes on executive compensation and golden parachute payments.

Recently Issued Accounting Pronouncements

We have evaluated new accounting pronouncements that have recently been issued and have determined that there are no new accounting pronouncements that should be described in this section that will have a material impact the Company’s operations, financial condition or liquidity in future periods. Refer to Note 1 of the Company’s audited consolidated financial statements for a discussion of recent accounting pronouncements that have been adopted by the Company or that will require enhanced disclosures in the Company’s financial statements in future periods.

Results of Operations

Net income was $37.3 million, or $2.37 per diluted common share, for the year ended December 31, 2018 compared with $17.6 million, or $1.31 per diluted common share, for the year ended December 31, 2017, an increase of $19.7 million, or 111.6%. The increase in net income was primarily the result of a $24.9 million increase in net interest income and an $8.9 million decrease in the provision for loan losses partially offset by a $16.8 million increase in noninterest expense. Net income was $17.6 million, or $1.31 per diluted common share, for the year ended December 31, 2017 compared with $22.9 million, or $1.75 per diluted common share, for the year ended December 31, 2016. Returns on average common equity were 9.02%, 5.92% and 8.36%, returns on average assets were 1.11%, 0.65% and 0.98% and efficiency ratios were 63.68%, 63.89% and 62.34% for the years ended December 31, 2018, 2017 and 2016, respectively. The efficiency ratio is calculated by dividing total noninterest expense by the sum of net interest income plus noninterest income, excluding net gains and losses on the sale of loans, securities and assets (including the sale of the two acquired Central Texas branches in 2016). Additionally, taxes and provision for loan losses are not part of the efficiency ratio calculation.

Net Interest Income

Net interest income is the difference between interest income on earning assets, such as loans and securities, and interest expense on liabilities, such as deposits and borrowings, which are used to fund those assets. Net interest income is our largest source of revenue, representing 94.3% of total revenue during 2018. Tax equivalent net interest margin is the ratio of taxable-equivalent net interest income to average earning assets for the period. The level of interest rates and the volume and mix of earning assets and interest-bearing liabilities impact net interest income and net interest margin.

The Federal Reserve influences the general market rates of interest, including the deposit and loan rates offered by many financial institutions. Our loan portfolio is affected by changes in the prime interest rate. The prime interest rate, which is the rate offered on loans to borrowers with strong credit, remained at 3.50% during most of 2016. In December 2016, the prime rate increased 25 basis points to 3.75%. During 2017, the prime rate increased 75 basis points (25 basis points in each of March, June and December) to end the year at 4.50%. During 2018, the prime rate increased 100 basis points (25 basis points in each of March, June, September and December) to end the year at to 5.50%. Our loan portfolio is also impacted by changes in the London Interbank Offered Rate (LIBOR). At December 31, 2018, the one-month and three-month U.S. dollar LIBOR rates were 2.50% and 2.81%, respectively, while at December 31, 2017, the one-month and three-month U.S. dollar LIBOR rates were 1.57% and 1.69%, respectively, and at December 31, 2016, the one-month and three-month U.S. dollar LIBOR rates were 0.77% and 1.00%, respectively.

The effective federal funds rate, which is the cost of immediately available overnight funds, remained at 0.50% during most of 2016. In December 2016, the effective federal funds rate increased 25 basis points to end the year at 0.75%. During 2017, the effective federal funds rate increased 75 basis points (25 basis points in each of March, June and December) to end the year at 1.50%. During 2018, the effective federal funds rate increased 100 basis points (25 basis points in each of March, June, September and December) to end the period at 2.50%.

Year ended December 31, 2018 compared with the year ended December 31, 2017. Net interest income before the provision for loan losses for the year ended December 31, 2018 was $128.6 million compared with $103.7 million for the year ended December 31,

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2017, an increase of $24.9 million, or 24.0%. The increase in net interest income from the previous year was due to increased average interest-earning asset balances primarily from the acquisition of Post Oak, as well as organic growth for the year. Average interest-earning assets increased $582.6 million, or 23.7%, for the year ended December 31, 2018 compared with the year ended December 31, 2017.

Interest income was $158.2 million for the year ended December 31, 2018, an increase of $38.8 million, or 32.5%, compared with the year ended December 31, 2017 primarily due to an increase of $37.9 million of interest income and fees on loans. This increase in interest income and fees on loans during the year ended December 31, 2018 was primarily due to the Post Oak acquisition and organic growth. Average loans outstanding increased $571.0 million, or 27.4%, for the same period. Additionally, interest income during the years ended December 31, 2018 and 2017, included acquisition accounting loan discount accretion of $2.7 million and $632 thousand, respectively.

Interest expense was $29.6 million for the year ended December 31, 2018, an increase of $13.9 million, or 88.0%, compared with the year ended December 31, 2017. This increase was primarily due to an increase in average interest-bearing deposits, the subordinated debt issued in December 2017 and rising expenses associated with higher funding costs on interest-bearing liabilities. Average interest-bearing liabilities increased $370.1 million, or 21.5%, for the year ended December 31, 2018 compared with the year ended December 31, 2017 primarily due to the increase in average interest-bearing deposits. Average interest-bearing deposits increased $361.3 million primarily due to deposits assumed in the Post Oak acquisition and organic growth. Additionally, average subordinated debt increased $37.6 million during the year ended December 31, 2018 due to the issuance in December 2017. The increase in interest-bearing deposits for the year ended December 31, 2018 compared to the year ended December 31, 2017 was primarily due to the increase in average certificates and other time deposits of $192.3 million, or 25.7%. The cost of average interest-bearing liabilities increased to 142 basis points for the year ended December 31, 2018 compared to 92 basis points for the same period in 2017.

Tax equivalent net interest margin, defined as net interest income adjusted for tax-free income divided by average interest-earning assets, for the year ended December 31, 2018 was 4.27%, a decrease of 7 basis points compared to 4.34% for the year ended December 31, 2017. The decrease in the net interest margin on a tax equivalent basis was primarily due to an increase in funding costs on certificates of deposit and other borrowed funds partially offset by an increase in the impact of net acquisition accounting adjustments. The average yield on interest-earning assets and the average rate paid on interest-bearing liabilities increased during 2018. The average yield on interest-earning assets and the average rate paid on interest-bearing liabilities are primarily impacted by changes in market interest rates as well as changes in the volume and relative mix of the underlying assets and liabilities. The impact of net acquisition accounting adjustments of $3.1 million and $527 thousand on the tax equivalent net interest margin was an increase of 10 basis points and 2 basis points for the years ended December 31, 2018 and 2017, respectively. Tax equivalent adjustments to net interest margin are the result of increasing income from tax-free securities by an amount equal to the taxes that would have been paid if the income were fully taxable based on a 21% federal tax rate for the year ended December 31, 2018 and 35% rate for the same period in 2017, thus making tax-exempt yields comparable to taxable asset yields. Beginning January 1, 2018, tax equivalent yields and the net interest margin were based upon a tax rate of 21% as a result of the Tax Cuts and Jobs Act enacted on December 22, 2017.

Year ended December 31, 2017 compared with the year ended December 31, 2016. Net interest income before the provision for loan losses for the year ended December 31, 2017 was $103.7 million compared with $89.9 million for the year ended December 31, 2016, an increase of $13.8 million, or 15.4%. The increase in net interest income was primarily due to the increase in average interest-earning assets of $343.6 million, or 16.3%, for the year ended December 31, 2017 compared with the year ended December 31, 2016. The increase in our average interest-earning assets during the year ended December 31, 2017 as compared to the year ended 2016 was primarily due to organic loan growth.

Interest income was $119.4 million for the year ended December 31, 2017, an increase of $18.7 million, or 18.5%, compared with the year ended December 31, 2016 primarily due to an increase of $17.0 million of interest income and fees on loans during the year ended December 31, 2017 compared to the same period in 2016 as a result of the increase in average loans outstanding of $326.1 million for the same period. The increase in interest income during the years ended December 31, 2017 and 2016, included acquisition accounting loan discount accretion of $632 thousand and $1.4 million, respectively.

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Interest expense was $15.8 million for the year ended December 31, 2017, an increase of $4.9 million, or 44.5%, compared with the year ended December 31, 2016. This increase was primarily due to an increase in average interest-bearing liabilities and an increase in the funding costs on interest-bearing liabilities. Average interest-bearing liabilities increased $285.7 million, or 19.9%, for the year ended December 31, 2017 compared with the year ended December 31, 2016. The increase in average interest-bearing liabilities was primarily due to the increase in average interest-bearing deposits of $223.3 million and the increase in average borrowed funds of $60.3 million during the year ended December 31, 2017. The significant increase in interest-bearing deposits for the year ended December 31, 2017 compared to the year ended December 31, 2016 was impacted by the increase in average certificates and other time deposits of $100.0 million, or 15.4%.

Tax equivalent net interest margin for the year ended December 31, 2017 was 4.34%, a decrease of 3 basis points compared to 4.37% for the year ended December 31, 2016. The decrease in the net interest margin on a tax equivalent basis was primarily due to an increase in funding costs on certificates of deposit and other borrowed funds and a decrease in the impact of net acquisition accounting adjustments. The average yield on interest earning assets and the average rate paid on interest-bearing liabilities increased during 2017. The average yield on interest-earning assets and the average rate paid on interest-bearing liabilities are primarily impacted by changes in market interest rates as well as changes in the volume and relative mix of the underlying assets and liabilities. The impact of net acquisition accounting adjustments of $527 thousand and $1.5 million on the tax equivalent net interest margin was an increase of 2 basis points and 7 basis points for the years ended December 31, 2017 and 2016, respectively. Tax equivalent adjustments to net interest margin are the result of increasing income from tax-free securities by an amount equal to the taxes that would have been paid if the income were fully taxable based on a 35% federal tax rate, thus making tax-exempt yields comparable to taxable asset yields. The tax equivalent yields and net interest margin during the comparable periods are presented based upon a tax rate of 35%.

The following table presents, for the periods indicated, the total dollar amount of average balances, interest income from average interest-earning assets and the annualized resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed in both dollars and rates. Any nonaccruing loans have been included in the table as loans carrying a zero yield.

	For the Years Ended December 31,								
	2018			2017			2016		
	Average Balance	Interest Earned/ Interest Paid	Average Yield/ Rate	Average Balance	Interest Earned/ Interest Paid	Average Yield/ Rate	Average Balance	Interest Earned/ Interest Paid	Average Yield/ Rate
	(Dollars in thousands)								
Assets									
Interest-Earning Assets:									
Loans[1]	$2,652,355	$148,223	5.59%	$2,081,370	$110,331	5.30%	$1,755,319	$93,356	5.32%
Securities	317,329	8,527	2.69%	324,926	8,445	2.60%	270,789	6,851	2.53%
Deposits in other financial institutions	70,145	1,473	2.10%	50,917	662	1.30%	87,485	571	0.65%
Total interest-earning assets	3,039,829	$158,223	5.21%	2,457,213	$119,438	4.86%	2,113,593	$100,778	4.77%
Allowance for loan losses	(24,077)			(20,536)			(15,200)		
Noninterest-earning assets	349,408			262,549			240,202		
Total assets	$3,365,160			$2,699,226			$2,338,595		
Liabilities and Shareholders' Equity									
Interest-Bearing Liabilities:									
Interest-bearing demand deposits	$224,210	$1,834	0.82%	$156,527	$597	0.38%	$104,212	$334	0.32%
Money market and savings deposits	637,722	4,644	0.73%	536,415	2,562	0.48%	465,403	2,103	0.45%
Certificates and other time deposits	940,356	15,478	1.65%	748,086	9,060	1.21%	648,075	7,044	1.09%
Borrowed funds	240,952	4,788	1.99%	269,633	2,922	1.08%	209,379	945	0.45%

Subordinated debt	48,776	2,900	5.95%	11,208	629	5.61%	9,138	488	5.34%
Total interest-bearing liabilities	2,092,016	29,644	1.42%	1,721,869	$15,770	0.92%	1,436,207	$10,914	0.76%
Noninterest-Bearing Liabilities:									
Noninterest-bearing demand deposits	848,276			672,101			620,701		
Other liabilities	11,427			7,629			8,476		
Total liabilities	2,951,719			2,401,599			2,065,384		
Shareholders' equity	413,441			297,627			273,211		
Total liabilities and shareholders' equity	$3,365,160			$2,699,226			$2,338,595		
Net interest rate spread			3.79%			3.94%			4.01%
Net interest income and margin(2)		$128,579	4.23%		$103,668	4.22%		$89,864	4.25%
Net interest income and margin (tax equivalent)(3)		$129,652	4.27%		$106,669	4.34%		$92,330	4.37%

(1) Includes loans held for sale.

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

(3) In order to make pretax income and resultant yields on tax-exempt investments and loans comparable to those on taxable investments and loans, a tax-equivalent adjustment has been computed using a federal income tax rate of 21% for the year ended December 31, 2018 and 35% for the years ended December 31, 2017 and 2016 and other applicable effective tax rates.

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

	For the Years Ended December 31,						
	2018 vs. 2017 Increase (Decrease) Due to Change in			2017 vs. 2016 Increase (Decrease) Due to Change in			
	Volume	Rate	Total	Volume	Rate	Days	Total
	(Dollars in thousands)						
Interest-Earning assets:							
Loans	$30,268	$7,625	$37,893	$17,294	$(64)	$(255)	$16,975
Securities	(198)	279	81	1,387	226	(19)	1,594
Deposits in other financial institutions	250	562	812	(237)	330	(2)	91
Total increase (decrease) in interest income	30,320	8,466	38,786	18,444	492	(276)	18,660
Interest-Bearing liabilities:							
Interest-bearing demand deposits	258	979	1,237	169	95	(1)	263
Money market and savings deposits	484	1,598	2,082	327	138	(6)	459
Certificates and other time deposits	2,329	4,089	6,418	1,106	929	(19)	2,016
Borrowed funds	(311)	2,177	1,866	275	1,705	(3)	1,977
Subordinated debt	2,108	163	2,271	112	30	(1)	141
Total increase (decrease) in interest expense	4,868	9,006	13,874	1,989	2,897	(30)	4,856
Increase (decrease) in net interest income	$25,452	$(540)	$24,912	$16,455	$(2,405)	$(246)	$13,804

Provision for Loan Losses

Our allowance for loan losses is established through charges to income in the form of the provision in order to bring our allowance for loan losses to a level deemed appropriate by management. The allowance for loan losses at December 31, 2018 and December 31, 2017 was $26.3 million and $23.6 million, respectively, representing 0.71% and 1.04% of total loans as of such dates. We recorded a $4.2 million provision for loan losses for the year ended December 31, 2018 compared with $13.2 million for the year ended December 31, 2017. The increased provision for the year ended December 31, 2017 was primarily due to an increase in organic loan growth, net charge-offs of $7.5 million, estimated losses related to Hurricane Harvey and an increase of $702 thousand of allowance on impaired loans. The provision for loan losses for the year ended December 31, 2017 was $13.2 million compared with $5.5 million for the year ended December 31, 2016.

Acquired loans are initially recorded at fair value based on a discounted cash flow valuation methodology that considers, among other things, projected default rates, losses given existing defaults and recovery rates. Loans acquired from Post Oak were initially recorded at fair value and no corresponding allowance for loan losses was recorded for these loans at acquisition date. We recognized a discount on the acquired loans which will be prospectively accreted, increasing our basis in such loans. At December 31, 2018, the balance of the acquisition accounting discount was $14.2 million.

Noninterest Income

Our primary sources of noninterest income are service charges on deposit accounts, nonsufficient funds fees, rebates from our correspondent bank and debit card and ATM card income. Noninterest income does not include loan origination fees which are recognized over the life of the related loan as an adjustment to yield using the interest method.

Year ended December 31, 2018 compared with the year ended December 31, 2017. Noninterest income totaled $7.7 million for the year ended December 31, 2018 compared to $5.9 million for the year ended December 31, 2017, an increase of $1.9 million, or

31.6%. Noninterest income increased in 2018 due to increased rebates from correspondent bank and increased noninterest income driven primarily from increased deposit and loan balances, mitigated by losses on other real estate owned during 2018.

Year ended December 31, 2017 compared with the year ended December 31, 2016. Noninterest income totaled $5.9 million for the year ended December 31, 2017 compared to $7.3 million for the year ended December 31, 2016, a decrease of $1.4 million, or 19.4%. This decrease was primarily due to the $2.1 million gain, $1.3 million after-tax, on the sale of the two Central Texas branch locations completed during the first quarter 2016.

The following table presents, for the periods indicated, the major categories of noninterest income:

	For the Years Ended December 31,		Increase	For the Years Ended December 31,		Increase
	2018	2017	(Decrease)	2017	2016	(Decrease)
	(Dollars in thousands)					
Nonsufficient funds fees	$755	$685	$ 70	$685	$661	$ 24
Service charges on deposit accounts	869	783	86	783	677	106
Gain on sale of branch assets	—	—	—	—	2,050	(2,050)
Gain on sale of securities	—	18	(18)	18	30	(12)
(Loss) gain on sale of other real estate	(428)	6	(434)	6	266	(260)
Bank owned life insurance income	579	585	(6)	585	626	(41)
Debit card and ATM card income	1,331	929	402	929	725	204
Rebate from correspondent bank	2,609	1,327	1,282	1,327	650	677
Other(1)	1,998	1,528	470	1,528	1,583	(55)
Total noninterest income	$7,713	$5,861	$ 1,852	$5,861	$7,268	$ (1,407)

(1) Other includes wire transfer and letter of credit fees, among other items.

Noninterest Expense

Year ended December 31, 2018 compared with the year ended December 31, 2017. Noninterest expense was $86.8 million for the year ended December 31, 2018 compared to $70.0 million for the year ended December 31, 2017, an increase of $16.8 million, or 24.0%. This increase was primarily due to core system conversion expenses of $1.8 million, acquisition and merger-related expenses of $1.7 million, additional expenses related to increased headcount and bank offices from the Post Oak acquisition and increased expenses to support organic growth initiatives during the year ended December 31, 2018.

Year ended December 31, 2017 compared with the year ended December 31, 2016. Noninterest expense was $70.0 million for the year ended December 31, 2017 compared to $59.3 million for the year ended December 31, 2016, an increase of $10.7 million, or 18.1%. This increase was primarily due to core system conversion expenses of $1.1 million, professional fees, regulatory assessments and FDIC insurance and salaries and benefits related to supporting growth initiatives.

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The following table presents, for the periods indicated, the major categories of noninterest expense:

	For the Years Ended December 31,		Increase	For the Years Ended December 31,		Increase
	2018	2017	(Decrease)	2017	2016	(Decrease)
	(Dollars in thousands)					
Salaries and employee benefits[1]	$56,704	$44,745	$ 11,959	$44,745	$38,858	$ 5,887
Net occupancy and equipment	5,845	5,452	393	5,452	4,944	508
Depreciation	2,132	1,637	495	1,637	1,627	10
Data processing and software amortization	5,120	4,047	1,073	4,047	2,633	1,414
Professional fees	2,009	2,926	(917)	2,926	2,234	692
Regulatory assessments and FDIC insurance	2,309	2,273	36	2,273	1,581	692
Core deposit intangibles amortization	1,815	781	1,034	781	785	(4)
Communications	1,185	983	202	983	1,055	(72)
Advertising	1,725	1,289	436	1,289	945	344
Acquisition and merger-related expenses	1,661	—	1,661	—	—	—
Other real estate expense	313	331	(18)	331	189	142
Printing and supplies	388	299	89	299	241	58
Other	5,581	5,199	382	5,199	4,166	1,033
Total noninterest expense	$86,787	$69,962	$ 16,825	$69,962	$59,258	$ 10,704

(1) Total salaries and employee benefits includes $1.7 million, $1.8 million and $1.5 million in stock based compensation expense for the years ended December 31, 2018, 2017 and 2016, respectively.

Salaries and Employee Benefits. Salaries and benefits were $56.7 million for the year ended December 31, 2018, an increase of $12.0 million, or 26.7%, compared to the year ended December 31, 2017. We experienced a significant increase in the total size of our workforce between these periods as our full-time equivalent employees were 569 at December 31, 2018 compared to 375 for the year ended December 31, 2017. The primary increase in headcount was from employees added through the Post Oak acquisition and to support organic growth.

Salaries and benefits were $44.7 million for the year ended December 31, 2017, an increase of $5.9 million, or 15.2%, compared to the year ended December 31, 2016. This increase was primarily attributable to the addition of high quality bankers and key personnel hired to strengthen our infrastructure to support our future growth plans. The total size of our workforce between these periods increased to 375 full-time equivalent employees at December 31, 2017 from 334 employees at December 31, 2016.

Net Occupancy and Equipment. Net occupancy and equipment expenses increased $393 thousand, or 7.2%, for the year ended December 31, 2018 to $5.8 million compared to $5.5 million for the year ended December 31, 2017. This increase was primarily due to expenses associated with the infrastructure and facilities added through the Post Oak acquisition and continued build-out needed to support our growth.

Net occupancy and equipment expenses increased $508 thousand, or 10.3%, for the year ended December 31, 2017 to $5.5 million compared to $4.9 million for the year ended December 31, 2016. This increase was primarily due to general business growth and the continued build-out needed to support our growth.

Data Processing and Software Amortization. Data processing and software amortization increased $1.1 million, or 26.5%, for the year ended December 31, 2018 compared to the year ended December 31, 2017. This increase was primarily due to expenses incurred to complete the conversion of our core technology platform to better serve our customers, added scale and expense from the Post Oak acquisition and increase efficiencies.

Data processing and software amortization increased $1.4 million, or 53.7%, for the year ended December 31, 2017 compared to the year ended December 31, 2016. This increase was primarily due to expenses related to the conversion of our core technology platform to better serve our customers and increase efficiencies.

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Professional Fees. Professional fees decreased $917 thousand, or 31.3%, for the year ended December 31, 2018 to $2.0 million from $2.9 million for the year ended December 31, 2017 due to elevated expenses in 2017 as we focused on enhancing the operational infrastructure required to pursue our growth strategy.

Professional fees increased $692 thousand, or 31.0%, for the year ended December 31, 2017 to $2.9 million from $2.2 million for the year ended December 31, 2016 as we continued to focus on enhancing the operational infrastructure required to pursue our growth strategy.

Core deposit intangibles amortization. Core deposit intangibles amortization increased $1.0 million, or 132.4%, for the year ended December 31, 2018 to $1.8 million from $781 thousand for the year ended December 31, 2017 primarily due to increased core deposit intangibles amortization resulting from the Post Oak acquisition.

Acquisition and merger-related expenses. Acquisition and merger-related expenses are legal, advisory and accounting fees associated with the Post Oak acquisition. These expenses also include data processing conversion costs and contract termination costs that resulted from the Post Oak acquisition.

Efficiency Ratio

The efficiency ratio is a supplemental financial measure utilized in management's internal evaluation of our performance and is not calculated based on generally accepted accounting principles. We calculate our efficiency ratio by dividing total noninterest expense by the sum of net interest income and noninterest income, excluding net gains and losses on the sale of loans, securities and assets (including the sale of the two acquired Central Texas branches). Additionally, taxes and provision for loan losses are not part of this calculation. An increase in the efficiency ratio indicates that more resources are being utilized to generate the same volume of income, while a decrease would indicate a more efficient allocation of resources. Our efficiency ratio was 63.68% for the year ended December 31, 2018 compared with 63.89% for the year ended December 31, 2017. The efficiency ratio for 2018 was impacted by $1.8 million of core system conversion expenses and $1.7 million of merger-related expenses related to the Post Oak acquisition. The efficiency ratio for 2017 was impacted by $1.1 million of core system conversion expenses in 2017.

Our efficiency ratio was 63.89% for the year ended December 31, 2017 compared with 62.34% for the year ended December 31, 2016.

We monitor the efficiency ratio in comparison with changes in our total assets and loans, and we believe that maintaining or reducing the efficiency ratio during periods of growth, as we did from 2017 to 2018, demonstrates the scalability of our operating platform. We expect to continue to benefit from our scalable platform in future periods as we continue to monitor overhead expenses necessary to support our growth.

Income Taxes

The amount of federal and state income tax expense is influenced by the amount of pre-tax income, the amount of tax-exempt income and the amount of other nondeductible expenses. Income tax expense decreased $799 thousand, or 9.1%, to $7.9 million for the year ended December 31, 2018 compared with $8.7 million for the same period in 2017 primarily due to the reduction in the U.S. federal statutory income tax rate to 21% under the Tax Cuts and Jobs Act enacted on December 22, 2017, partially offset by an increase in pre-tax net income. For the year ended December 31, 2017, income tax expense decreased $807 thousand, or 8.4%, compared with $9.6 million for the year ended December 31, 2016. This decrease in income tax expense year over year was primarily due to a decrease in pre-tax net income.

The effective tax rates were 17.6%, 33.2% and 29.5% for the years ended December 31, 2018, 2017 and 2016, respectively. The effective tax rate for 2018 was impacted by the reduction in the U.S. federal statutory income tax rate to 21% under the Tax Cuts and Jobs Act enacted on December 22, 2017. As a result of the reduction in the U.S.

federal statutory income tax rate, we recognized a provisional net income tax expense totaling $2.6 million for the year ended December 31, 2017. Under ASC 740, Income Taxes, the effect of income tax law changes on deferred taxes should be recognized as a component of income tax expense related to continuing operations in the period in which the law is enacted. This requirement applies not only to items initially recognized in continuing operations, but also to items initially recognized in other comprehensive income.

Tax Cuts and Jobs Act. The Tax Cuts and Jobs Act was enacted on December 22, 2017. Among other things, the new law (i) establishes a new, flat corporate federal statutory income tax rate of 21%, (ii) eliminates the corporate alternative minimum tax and allows the use of any such carryforwards to offset regular tax liability for any taxable year, (iii) limits the deduction for net interest expense incurred by U.S. corporations, (iv) allows businesses to immediately expense, for tax purposes, the cost of new investments in certain qualified depreciable assets, (v) eliminates or reduces certain deductions related to meals and entertainment expenses, (vi) modifies the limitation on excessive employee remuneration to eliminate the exception for performance-based compensation and clarifies the definition of a covered employee and (vii) limits the deductibility of deposit insurance premiums. The Tax Cuts and Jobs Act also significantly changes U.S. tax law related to foreign operations; however, such changes do not currently impact us.

Quarterly Financial Information

The following table presents certain unaudited consolidated quarterly financial information regarding the results of operations for the quarters ended December 31, September 30, June 30 and March 31 in the years ended December 31, 2018 and 2017. This information should be read in conjunction with our consolidated financial statements as of and for the fiscal years ended December 31, 2018 and 2017 appearing elsewhere in this Annual Report on Form 10-K.

	Interest Income	Net Interest Income	Net Income Attributable to Common Shareholders	Earnings Per Share(1) Basic	Earnings Per Share(1) Diluted
	(Dollars in thousands, except per share data)				
2018					
First quarter	$32,391	$26,889	$ 7,711	$0.58	$ 0.57
Second quarter	34,193	27,816	7,556	0.57	0.55
Third quarter	35,336	28,036	8,879	0.66	0.65
Fourth quarter	56,303	45,838	13,163	0.60	0.59
2017					
First quarter	$27,512	$24,128	$ 6,047	$0.46	$ 0.45
Second quarter	28,987	25,107	5,395	0.41	0.40
Third quarter	30,901	26,997	2,986	0.23	0.22
Fourth quarter	32,038	27,436	3,204	0.24	0.24

(1) Earnings per share are computed independently for each of the quarters presented and therefore may not total earnings per share for the year.

Financial Condition

Loan Portfolio

At December 31, 2018, total loans were $3.71 billion, an increase of $1.44 billion, or 63.3%, compared with December 31, 2017 primarily due to loans acquired in the Post Oak acquisition and organic loan growth.

Total loans as a percentage of deposits were 101.3% and 102.6% as of December 31, 2018 and December 31, 2017, respectively. Total loans as a percentage of assets were 79.7% and 79.4% as of December 31, 2018 and December 31, 2017, respectively.

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The following table summarizes our loan portfolio by type of loan as of the dates indicated:

	As of December 31, 2018 Amount	Percent	2017 Amount	Percent	2016 Amount	Percent	2015 Amount	Percent	2014 Amount	Percent
	(Dollars in thousands)									
Loans held for sale[(1)]	$—	0.0 %	$—	0.0 %	$—	0.0 %	$27,887	1.7 %	$—	0.0 %
Commercial and industrial	$702,037	18.9 %	$457,129	20.1 %	$416,752	22.0 %	$383,044	22.7 %	$242,034	24.2 %
Mortgage warehouse	48,274	1.3 %	69,456	3.1 %	67,038	3.5 %	59,071	3.5 %	28,329	2.8 %
Real estate:										
Commercial real estate (including multi-family residential)	1,650,912	44.6 %	1,080,247	47.5 %	891,989	47.2 %	745,595	44.4 %	429,986	42.9 %
Commercial real estate construction and land development	430,128	11.6 %	243,389	10.7 %	159,247	8.4 %	154,646	9.2 %	85,484	8.5 %
1-4 family residential (including home equity)	649,311	17.5 %	301,219	13.3 %	246,987	13.1 %	205,200	12.2 %	135,127	13.5 %
Residential construction	186,411	5.0 %	109,116	4.8 %	98,657	5.2 %	93,848	5.6 %	72,402	7.2 %
Consumer and other	41,233	1.1 %	10,320	0.5 %	10,965	0.6 %	11,761	0.7 %	8,692	0.9 %
Total loans held for investment	3,708,306	100.0%	2,270,876	100.0%	1,891,635	100.0%	1,653,165	98.3 %	1,002,054	100.0%
Total loans	3,708,306	100.0%	2,270,876	100.0%	1,891,635	100.0%	1,681,052	100.0%	1,002,054	100.0%
Allowance for Loan Losses	(26,331)		(23,649)		(17,911)		(13,098)		(8,246)	
Loans, net	$3,681,975		$2,247,227		$1,873,724		$1,667,954		$993,808	

(1) Consists of loans at two former F&M Bancshares locations in Central Texas that the Company acquired on January 1, 2015. As of December 31, 2015, loans held for sale consisted of $13.2 million of commercial and industrial loans, $11.6 million of commercial real estate (including multifamily residential) loans, $2.3 million of l-4 family residential (including home equity) loans and $803 thousand of consumer and other loans. Loans held for sale are carried at lower of aggregate cost or fair value.

Our lending activities originate from the efforts of our bankers with an emphasis on lending to individuals, professionals, small to medium-sized businesses and commercial companies generally located in the Houston region. Our strategy for credit risk management generally includes well-defined, centralized credit policies, uniform underwriting criteria and ongoing risk monitoring and review processes for all credit exposures. The strategy generally emphasizes regular credit examinations and management reviews of loans. We have certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. We maintain an independent loan review department that reviews and validates the credit risk program on a periodic basis. In addition, an independent third-party loan review is performed on a semi-annual basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by bankers and credit personnel and contained in our policies and procedures.

The principal categories of our loan portfolio (including loans held for sale) are discussed below:

Commercial and Industrial. We make commercial loans in our market area that are underwritten on the basis of the borrower’s ability to service the debt from income. Our commercial and industrial loan portfolio increased $244.9 million, or 53.6%, to $702.0 million as of December 31, 2018 compared to $457.1 million as of December 31, 2017.

Mortgage Warehouse. We make loans to unaffiliated mortgage loan originators collateralized by mortgage promissory notes which are segregated in our mortgage warehouse portfolio. These promissory notes originated by our mortgage warehouse customers carry terms and conditions as would be expected in the competitive permanent mortgage market and serve as collateral under a traditional mortgage warehouse arrangement whereby such promissory notes are warehoused under a revolving credit facility to allow for the end investor (or purchaser) of the note to receive a complete loan package and remit funds to the bank. For mortgage promissory notes secured by residential property, the warehouse time is normally 10 to 20 days. For mortgage promissory notes secured by commercial property, the warehouse time is normally 40 to 50 days. The funded balance of the mortgage warehouse portfolio can have significant fluctuation based upon market demand for the product, level of home sales and refinancing activity, market interest rates and velocity of end investor processing times. Volumes of the portfolio tend to peak at the end of each month. Our mortgage warehouse portfolio decreased $21.2 million, or 30.5%, to $48.3 million as of December 31, 2018 compared to $69.5 million as of December 31, 2017.

Commercial Real Estate (Including Multi-Family Residential). We make loans collateralized by owner-occupied, nonowner-occupied and multi-family real estate to finance the purchase or ownership of real estate. As of December 31, 2018 and December 31, 2017, 51.4% of our commercial real estate loans were owner-occupied. Our commercial real estate loan portfolio increased $570.7 million, or 52.8%, to $1.65 billion as of December 31, 2018 from $1.08 billion as of December 31, 2017 as a result of commercial real estate loans acquired from the Post Oak acquisition and organic loan growth. Included in our commercial real estate portfolio are multi-family residential loans. Our multi-family loans increased $11.2 million, or 16.6%, to $78.4 million as of December 31, 2018 from $67.2 million as of December 31, 2017. We had 135 multi-family loans with an average loan size of $581.4 thousand as of December 31, 2018.

Commercial Real Estate Construction and Land Development. We make commercial real estate construction and land development loans to fund commercial construction, land acquisition and real estate development construction. As of December 31, 2018 and December 31, 2017, 29.4% and 26.4%, respectively, of our commercial real estate construction and land development loans were owner-occupied. Commercial real estate construction and land development land loans increased $186.7 million, or 76.7%, to $430.1 million as of December 31, 2018 compared to $243.4 million as of December 31, 2017 primarily as a result of loans acquired from Post Oak and organic loan growth.

1-4 Family Residential (Including Home Equity). Our residential real estate loans include the origination of 1-4 family residential mortgage loans (including home equity and home improvement loans and home equity lines of credit) collateralized by owner-occupied residential properties located in our market area. Our residential real estate portfolio (including home equity) increased $348.1 million, or 115.6%, to $649.3 million as of December 31, 2018 from $301.2 million as of December 31, 2017. The home equity, home improvement and home equity lines of credit portion of our residential real estate portfolio increased $51.7 million, or 118.2%, to $95.4 million as of December 31, 2018 from $43.8 million as of December 31, 2017. These increases were primarily the result of loans acquired as part of the Post Oak acquisition.

Residential Construction. We make residential construction loans to home builders and individuals to fund the construction of single-family residences with the understanding that such loans will be repaid from the proceeds of the sale of the homes by builders or with the proceeds of a mortgage loan. These loans are secured by the real property being built and are made based on our assessment of the value of the property on an as-completed basis. Our residential construction loans portfolio increased $77.3 million, or 70.8%, to $186.4 million as of December 31, 2018 from $109.1 million as of December 31, 2017. This increase was primarily the result of loans acquired as part of the Post Oak acquisition.

Consumer and Other. Our consumer and other loan portfolio is made up of loans made to individuals for personal purposes. Our consumer and other loan portfolio increased $30.9 million, or 299.5%, to $41.2 million as of December 31, 2018 from $10.3 million as of December 31, 2017. This increase was primarily the result of loans acquired as part of the Post Oak acquisition.

The contractual maturity ranges of total loans in our loan portfolio and the amount of such loans with predetermined interest rates in each maturity range and the amount of loans with predetermined (fixed) interest rates and floating interest rates in each maturity range, in each case as of the date indicated, are summarized in the following tables:

	As of December 31, 2018			
	Due in One Year or Less	Due After One Year Through Five Years	Due After Five Years	Total
	(Dollars in thousands)			
Commercial and industrial	$314,719	$311,977	$75,341	$702,037
Mortgage Warehouse	48,274	—	—	48,274
Real estate:				
Commercial real estate (including multi family residential)	228,988	1,008,121	413,803	1,650,912
Commercial real estate construction	99,692	246,814	83,622	430,128

and land development				
1-4 family residential (including home equity)	85,143	396,085	168,083	649,311
Residential construction	126,432	41,526	18,453	186,411
Consumer and other	24,539	16,314	380	41,233
Total loans	$927,787	$2,020,837	$759,682	$3,708,306
Loans with predetermined (fixed) interest rates	$525,973	$1,741,140	$367,746	$2,634,859
Loans with floating interest rates	401,814	279,697	391,936	1,073,447
Total loans	$927,787	$2,020,837	$759,682	$3,708,306

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	As of December 31, 2017			
	Due in One Year or Less	Due After One Year Through Five Years	Due After Five Years	Total
	(Dollars in thousands)			
Commercial and industrial	$190,585	$209,797	$56,747	$457,129
Mortgage Warehouse	69,456	—	—	69,456
Real estate:				
Commercial real estate (including multi-family residential)	126,169	716,868	237,210	1,080,247
Commercial real estate construction and land development	69,291	139,956	34,142	243,389
1-4 family residential (including home equity)	48,109	148,673	104,437	301,219
Residential construction	97,189	2,839	9,088	109,116
Consumer and other	4,325	5,993	2	10,320
Total loans	$605,124	$1,224,126	$441,626	$2,270,876
Loans with predetermined (fixed) interest rates	$363,029	$1,119,854	$263,847	$1,746,730
Loans with floating interest rates	242,095	104,272	177,779	524,146
Total loans	$605,124	$1,224,126	$441,626	$2,270,876

Concentrations of Credit

The vast majority of our lending activity occurs in the Houston region. Our loans are primarily secured by real estate, including commercial and residential construction, owner-occupied and nonowner-occupied and multi-family commercial real estate, raw land and other real estate based loans located in the Houston region. As of December 31, 2018, 2017 and 2016, commercial real estate and commercial construction loans represented 56.1%, 58.3% and 53.6%, respectively, of our total loans including loans held for sale.

Asset Quality

We have procedures in place to assist us in maintaining the overall quality of our loan portfolio. We have established underwriting guidelines to be followed by our officers and monitor our delinquency levels for any negative or adverse trends.

We had $33.0 million, $13.3 million and $16.7 million in nonperforming loans as of December 31, 2018, 2017 and 2016, respectively. If interest on nonaccrual loans had been accrued under the original loan terms, $1.0 million, $733 thousand and $892 thousand would have been recorded as income for the years ended December 31, 2018, 2017 and 2016, respectively.

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The following table presents information regarding nonperforming assets as of the dates indicated:

	As of December 31, 2018	2017	2016	2015	2014
	(Dollars in thousands)				
Nonaccrual loans:					
Loans held for sale	$—	$—	$—	$209	$—
Commercial and industrial	10,861	6,437	3,896	2,664	1,527
Mortgage warehouse	—	—	—	—	—
Real estate:					
Commercial real estate (including multi-family residential)	17,776	6,110	11,663	2,006	1,653
Commercial real estate construction and land development	974	—	—	—	—
1-4 family residential (including home equity)	3,201	781	217	239	—
Residential construction	—	—	—	—	—
Consumer and other	141	—	12	66	4
Total nonaccrual loans	32,953	13,328	15,788	5,184	3,184
Accruing loans 90 or more days past due	—	—	911	—	—
Total nonperforming loans(1)	32,953	13,328	16,699	5,184	3,184
Other real estate	630	365	1,503	—	—
Other repossessed assets	—	205	286	131	—
Total nonperforming assets(2)	$33,583	$13,898	$18,488	$5,315	$3,184
Restructured loans(3)	$13,494	$17,526	$4,831	$491	$—
Nonperforming assets to total assets	0.72 %	0.49 %	0.75 %	0.25 %	0.25 %
Nonperforming loans to total loans	0.89 %	0.59 %	0.88 %	0.31 %	0.32 %

(1) Nonperforming loans include nonaccrual loans and loans past due 90 days or more and still accruing interest.

(2) Nonperforming assets include nonaccrual loans, loans past due 90 days or more and still accruing interest, repossessed assets and other real estate.

(3) Restructured loans represent the balance at the end of the respective period for those performing loans modified in a troubled debt restructuring that are not already presented as a nonperforming loan.

Potential problem loans consist of loans that are performing in accordance with contractual terms but for which management has concerns about the ability of an obligor to continue to comply with repayment terms because of the obligor's potential operating or financial difficulties. Management monitors these loans closely and reviews their performance on a regular basis. Potential problem loans contain potential weaknesses that could improve, persist or further deteriorate. At December 31, 2018 and 2017, we had $16.0 million and $17.9 million, respectively, in loans of this type which are not included in any of the nonaccrual or 90 days past due loan categories. At December 31, 2018, potential problem loans consisted of 23 credit relationships. Of the total outstanding balance at December 31, 2018, 39.6% related to nine customers in the energy-related industry, 19.6% related to two customers in the customer service industry, 15.8% related to three customers in the residential real estate rental industry, 7.5% related to one customer in the manufacturing industry, 5.2% related to one customer in the restaurant industry, 4.3% related to three customers in the commercial services industry, 2.7% related to one customer in the convenience store industry, 3.1% related to one customer in the commercial real estate development business, 1.2% related to one customer in the construction material industry and 1.0% related to two customers in the trucking industry. Weakness in these organizations' operating performance, financial condition and borrowing base deficits for certain energy related credits, among other factors, have caused us to heighten the attention given to these credits. As such, all of the loans identified as potential problem loans at December 31, 2018 were graded as substandard accruing loans. Potential problem loans impact the allocation of our allowance for loan losses as a result of our risk grade based allocation methodology. See Note 6 – Loans and Allowance for Loan Losses in the accompanying consolidated financial statements for details regarding our allowance allocation methodology.

Nonperforming assets increased $19.7 million to $33.6 million at December 31, 2018, from $13.9 million at December 31, 2017. Nonaccrual loans consisted of 87 separate credits at December 31, 2018 compared to 50 separate credits at December 31, 2017. Nonperforming assets were 0.91% of total loans at December 31, 2018 compared to 0.61% at December 31, 2017. Nonaccrual loans at December 31, 2018, included $5.3 million of loans acquired from Post Oak. See Note 2 – Acquisitions in the accompanying consolidated financial statements included elsewhere in this Annual Report on From 10-K for additional information regarding loans purchased from Post Oak.

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Allowance for Loan Losses

The allowance for loan losses is a valuation allowance that is established through charges to earnings in the form of a provision for loan losses. The amount of the allowance for loan losses is affected by the following: (1) charge-offs of loans that decrease the allowance, (2) subsequent recoveries on loans previously charged off that increase the allowance and (3) provisions for loan losses charged to income that increase the allowance.

Under accounting standards for business combinations, acquired loans are recorded at fair value on the date of acquisition. This fair value adjustment eliminates any of the seller's allowance associated with such loans as of the purchase date as any credit exposure associated with such loans is incorporated into the fair value adjustment. A provision for loan losses is recorded for the emergence of new incurred and estimable losses on acquired loans after the acquisition date in excess of the recorded discount.

All loans acquired from Post Oak were recorded at fair value without a carryover of the Post Oak allowance for loan losses. The discount recognized on acquired loans is prospectively accreted, increasing our basis in such loans. Due to acquisition accounting, our allowance for loan losses to total loans may not be comparable to our peers particularly as it relates to the allowance to gross loan percentage and the allowance to nonperforming loans. Recognizing that acquired purchased credit impaired loans have been de minimis, we monitor credit quality trends on a post-acquisition basis with an emphasis on past due, charge-off, classified loan and nonperforming trends. The amount of discount recorded by the Company on the acquisition date of the Post Oak acquisition was $17.0 million, or 1.43%, on loans acquired.

The remaining discount on the balance of acquired loans as of December 31, 2018 was $14.2 million. The discount on purchased loans considers anticipated credit losses on that portfolio; therefore, no allowance for credit losses was established on the acquisition date. The unaccreted discount represents additional protection against potential losses and is presented as a reduction of the recorded investment in the loans rather than an allowance for loan losses. We will continue to look at the portfolio for credit deterioration and establish additional allowances over the remaining discount as needed.

At December 31, 2018, our allowance for loan losses amounted to $26.3 million, or 0.71% of total loans, compared with $23.6 million, or 1.04%, as of December 31, 2017. During 2018, our allowance for loan losses as a percentage of loans decreased primarily due to the addition of acquired loans from Post Oak that were recorded at fair value without a carryover of the Post Oak allowance for loan losses.

The increase in the allowance of $2.7 million for the year ended December 31, 2018 as compared to the year ended December 31, 2017 was primarily due to an increase of $4.4 million of allowance on impaired loans partially offset by the reversal in 2018 of the $1.7 million Hurricane Harvey reserve that was established in the year 2017. We believe that the allowance for loan losses at December 31, 2018 was adequate to cover probable incurred losses in the loan portfolio as of such date.

The ratio of net charge-offs to average loans outstanding decreased to 0.06% for the year ended December 31, 2018 from 0.36% at December 31, 2017. Net charge-offs decreased $5.9 million during the year 2018 compared to 2017 primarily due to two commercial loan relationships that experienced financial difficulty in 2017.

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

	As of and for the Years Ended December 31,				
	2018	2017	2016	2015	2014
	(Dollars in thousands)				
Average loans outstanding	$2,652,355	$2,081,370	$1,755,319	$1,525,325	$917,218
Gross loans outstanding at end of period	3,708,306	2,270,876	1,891,635	1,681,052	1,002,054
Allowance for loan losses at beginning of period	23,649	17,911	13,098	8,246	6,655
Provision for loan losses	4,248	13,188	5,469	5,792	2,150
Charge-offs:					
Commercial and industrial loans	(2,424)	(7,673)	(722)	(935)	(567)
Mortgage warehouse	—	—	—	—	—
Real estate:					
Commercial real estate (including multi-family residential)	(42)	(124)	(129)	—	—
Commercial real estate construction and land development	—	—	—	—	—
1-4 family residential (including home equity)	(25)	—	—	(40)	—
Residential construction	—	—	—	—	—
Consumer and other	(24)	(196)	(49)	(65)	(40)
Total charge-offs for all loan types	(2,515)	(7,993)	(900)	(1,040)	(607)
Recoveries:					
Commercial and industrial loans	847	516	186	52	32
Mortgage warehouse	—	—	—	—	—
Real estate:					
Commercial real estate (including multi-family residential)	102	3	43	—	—
Commercial real estate construction and land development	—	10	—	18	—
1-4 family residential (including home equity)	—	10	10	—	—
Residential construction	—	—	—	24	—
Consumer and other	—	4	5	6	16
Total recoveries for all loan types	949	543	244	100	48
Net charge-offs	(1,566)	(7,450)	(656)	(940)	(559)
Allowance for loan losses at end of period	$26,331	$23,649	$17,911	$13,098	$8,246
Allowance for loan losses to total loans	0.71%	1.04%	0.95%	0.78%	0.82%
Net charge-offs to average loans	0.06%	0.36%	0.04%	0.06%	0.06%
Allowance for loan losses to nonperforming loans	79.90%	177.44%	107.26%	252.66%	258.98%

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

- for commercial and industrial loans, the operating results of the commercial, industrial or professional enterprise, the borrower’s business, professional and financial ability and expertise, the specific risks and volatility of income and operating results typical for businesses in that category and the value, nature and marketability of collateral;
- for commercial real estate (including multi-family residential) loans, the debt service coverage ratio (income from the property in excess of operating expenses compared to loan payment requirements), operating results of the owner in the case of owner-occupied properties, the loan to value ratio, the age and condition of the collateral and the volatility of income, property value and future operating results typical of properties of that type;
- for commercial real estate construction and land development and residential construction loans, the perceived feasibility of the project including the ability to sell developed lots or improvements constructed for resale or the ability to lease property constructed for lease, the quality and nature of contracts for presale or prelease, if any, experience and ability of the developer and loan to value ratio;
- for 1-4 family residential (including home equity) loans, the borrower’s ability to repay the loan, including a consideration of the debt to income ratio and employment and income stability, the loan to value ratio, and the age, condition and marketability of collateral; and

- for consumer and other loans, the individual borrower's income, current debt level, past credit history and the value of any available collateral.

Based on our review of our loan portfolio, we classify our loans by credit risk and track risk ratings. The following is a general description of the risk ratings we use:

- Loans classified as "watch" loans may still be of high quality, but have an element of risk added to the credit such as declining payment history, deteriorating financial position of the borrower or a decrease in collateral value.
- Loans classified as "special mention" have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of our credit position at some future date. They are characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected.
- Loans classified as "substandard" have well-defined weaknesses on a continuing basis and are inadequately protected by the current net worth and paying capacity of the borrower, impaired or declining collateral values, or a continuing downturn in their industry which is reducing their profits to below zero and having a significantly negative impact on their cash flow. Such loans are characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected.
- Loans classified as "doubtful" have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually are considered to be pass rated loans.

See Note 6 – Loans and Allowance for Loan Losses in our audited consolidated financial statement included elsewhere in this Annual Report on Form 10-K for additional information regarding how we estimate and evaluate the credit risk in our loan portfolio.

The following table shows the allocation of the allowance for loan losses among our loan categories and the percentage of the respective loan category to total loans held for investment as of the dates indicated. The allocation is made for analytical purposes and is not necessarily indicative of the categories in which future losses may occur. The total allowance is available to absorb losses from any loan category.

	As of December 31,									
	2018		2017		2016		2015		2014	
	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans
	(Dollars in thousands)									
Balance of allowance for loan losses applicable to:										
Commercial and industrial loans	$8,351	18.9 %	$7,694	20.1 %	$5,059	22.0 %	$3,644	23.6 %	$2,334	24.2 %

Mortgage Warehouse	—	1.3	%	—	3.1	%	—	3.5	%	—	3.5	%	—	2.8	%
Real estate:															
Commercial real estate (including multi-family residential)	11,901	44.6	%	10,253	47.5	%	8,950	47.2	%	5,914	45.0	%	3,799	42.9	%
Commercial real estate construction and land development	2,724	11.6	%	2,525	10.7	%	1,217	8.4	%	1,221	9.2	%	578	8.5	%
1-4 family residential (including home equity)	2,242	17.5	%	2,140	13.3	%	1,876	13.1	%	1,432	12.3	%	1,008	13.5	%
Residential construction	1,040	5.0	%	942	4.8	%	748	5.2	%	820	5.6	%	475	7.2	%
Consumer and other	73	1.1	%	95	0.5	%	61	0.6	%	67	0.8	%	52	0.9	%
Total allowance for loan losses	$26,331	100.0	%	$23,649	100.0	%	$17,911	100.0	%	$13,098	100.0	%	$8,246	100.0	%

Available for Sale Securities

We use our securities portfolio to provide a source of liquidity, to provide an appropriate return on funds invested, to manage interest rate risk, to meet pledging requirements and to meet regulatory capital requirements. As of December 31, 2018, the carrying amount of investment securities totaled $337.3 million, an increase of $27.7 million, or 8.9%, compared with $309.6 million as of December 31, 2017 primarily due to securities acquired from Post Oak. Securities represented 7.2% and 10.8% of total assets as of December 31, 2018 and 2017, respectively.

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All of the securities in our securities portfolio are classified as available for sale. Securities classified as available for sale are measured at fair value in the financial statements with unrealized gains and losses reported, net of tax, as accumulated comprehensive income or loss until realized. Interest earned on securities is included in interest income.

The following table summarizes the amortized cost and fair value of the securities in our securities portfolio as of the dates shown:

	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
U.S. Government and agency securities	$8,570	$ 161	$ (46)	$8,685
Municipal securities	219,068	1,258	(3,541)	216,785
Agency mortgage-backed pass-through securities	66,987	237	(1,029)	66,195
Corporate bonds and other	46,303	15	(690)	45,628
Total	$340,928	$ 1,671	$ (5,306)	$337,293

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
U.S. Government and agency securities	$8,507	$ 232	$ (24)	$8,715
Municipal securities	222,330	2,470	(1,842)	222,958
Agency mortgage-backed pass-through securities	32,014	159	(361)	31,812
Corporate bonds and other	46,247	62	(179)	46,130
Total	$309,098	$ 2,923	$ (2,406)	$309,615

Certain investment securities are valued at less than their historical cost. Management evaluates securities for OTTI at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. See “Securities” in Note 5 to our audited consolidated financial statements included elsewhere in this Annual Report on From 10-K for additional information regarding how and when management evaluates securities for OTTI.

As of December 31, 2018, we did not expect to sell any securities classified as available for sale with material unrealized losses, and management believes that we more likely than not will not be required to sell any securities before their anticipated recovery at which time we will receive full value for the securities. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. Management does not believe any of the securities are impaired due to reasons of credit quality. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such investments decline. Accordingly, as of December 31, 2018, management believes any impairment in our securities is temporary, and no impairment loss has been realized in our consolidated statements of income.

The following table summarizes the contractual maturity of securities and their weighted average yields as of the dates indicated. The contractual maturity of a mortgage-backed security is the date at which the last underlying mortgage matures. Available for sale securities are shown at amortized cost. For purposes of the table below, municipal securities are calculated on a tax equivalent basis.

	December 31, 2018									
	Within One Year		After One Year but Within Five Years		After Five Years but Within Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Total	Yield
	(Dollars in thousands)									
Available for Sale										
U.S. government and agency securities	$999	2.37 %	$5,399	3.30 %	$—	0.00 %	$2,172	2.74 %	$8,570	3.05 %
Municipal securities	3,772	2.06 %	37,422	2.03 %	86,391	3.05 %	91,483	3.84 %	219,068	3.19 %
Agency mortgage-backed pass-through securities	—	0.00 %	34	4.05 %	13,466	2.92 %	53,487	3.21 %	66,987	3.15 %
Corporate bonds and other	10,106	2.36 %	30,854	2.56 %	1,000	8.00 %	4,343	4.17 %	46,303	2.78 %
Total	$14,877	2.29 %	$73,709	2.34 %	$100,857	3.09 %	$151,485	3.61 %	$340,928	3.12 %

	December 31, 2017									
	Within One Year		After One Year but Within Five Years		After Five Years but Within Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Total	Yield
	(Dollars in thousands)									
Available for Sale										
U.S. government and agency securities	$2,018	1.46 %	$2,516	3.33 %	$1,396	3.44 %	$2,577	2.75 %	$8,507	2.73 %
Municipal securities	1,263	2.56 %	26,841	2.37 %	82,981	3.21 %	111,245	4.48 %	222,330	3.74 %
Agency mortgage-backed pass-through	—	0.00 %	—	0.00 %	5,074	2.29 %	26,940	2.90 %	32,014	2.81 %

securities										
Corporate bonds and other	7,552	2.19 %	29,538	2.45 %	9,157	2.99 %	—	0.00 %	46,247	2.51 %
Total	$10,833	2.10 %	$58,895	2.45 %	$98,608	3.14 %	$140,762	4.15 %	$309,098	3.43 %

The contractual maturity of mortgage-backed securities and collateralized mortgage obligations is not a reliable indicator of their expected life because borrowers generally have the right to prepay their obligations. Mortgage-backed securities and collateralized mortgage obligations are typically issued with stated principal amounts and are backed by pools of mortgage loans with varying maturities. The term of the underlying mortgages and loans may vary significantly due to the ability of a borrower to prepay and, in particular, monthly pay downs on mortgage-backed securities tend to cause the average life of the securities to be much different than the stated contractual maturity. During a period of increasing interest rates, fixed rate mortgage-backed securities do not tend to experience heavy prepayments of principal and, consequently, the average life of this security will be lengthened. If interest rates begin to fall, prepayments may increase, thereby shortening the estimated life of this security.

As of December 31, 2018 and 2017, we did not own securities of any one issuer (other than the U.S. government and its agencies or sponsored entities) for which the aggregate adjusted cost exceeded 10% of our consolidated shareholders’ equity.

The average yield of our securities portfolio was 2.69% during the year ended December 31, 2018 compared with 2.60% for the year ended December 31, 2017. The increase in average yield during 2018 compared to 2017 was primarily due to our increased investment in longer-term securities. This investment in higher-yielding securities replaced lower-yielding securities that matured or were called or prepaid.

Goodwill and Core Deposit Intangibles

Our goodwill as of December 31, 2018 was $223.1 million compared to $39.4 million as of December 31, 2017 due to goodwill resulting from the Post Oak acquisition. Goodwill resulting from business combinations represents the excess of the consideration paid over the fair value of the net assets acquired. Goodwill is assessed annually for impairment or when events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable.

Our core deposit intangibles, net, as of December 31, 2018 was $26.6 million compared to $3.3 million as of December 31, 2017 due to core deposit intangible resulting from the Post Oak acquisition. Core deposit intangibles are amortized over the estimated useful life of seven to ten years.

Deposits

Our lending and investing activities are primarily funded by deposits. We offer a variety of deposit accounts having a wide range of interest rates and terms including demand, savings, money market and certificates and other time accounts. We rely primarily on convenient locations, personalized service and our customer relationships to attract and retain these deposits. We seek customers that will both engage in a lending and deposit relationship with us.

Total deposits at December 31, 2018 were $3.66 billion, an increase of $1.45 billion, or 65.4%, compared with $2.21 billion at December 31, 2017. The deposit growth we experienced was largely the result of deposits assumed from the Post Oak acquisition and growth in our customer base, many of whom also established a deposit relationship with us. Noninterest-bearing deposits at December 31, 2018 were $1.21 billion, an increase of $526.2 million, or 77.0%, compared with $683.1 million at December 31, 2017. Interest-bearing deposits at December 31, 2018 were $2.45 billion, an increase of $922.4 million, or 60.3%, compared with $1.53 billion at December 31, 2017.

Total deposits at December 31, 2017 were $2.21 billion, an increase of $343.8 million, or 18.4%, compared with $1.87 billion at December 31, 2016. Noninterest-bearing deposits at December 31, 2017 were $683.1 million, an increase of $89.4 million, or 15.0%, compared with $593.8 million at December 31, 2016. Interest-bearing deposits at December 31, 2017 were $1.53 billion, an increase of $254.4 million, or 19.9%, compared with $1.28 billion at December 31, 2016.

The following table presents the daily average balances and weighted average rates paid on deposits for the periods indicated:

	Years Ended December 31,					
	2018		2017		2016	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
	(Dollars in thousands)					
Interest-bearing demand	$224,210	0.82 %	$156,527	0.38 %	$104,212	0.32 %
Money market and savings	637,722	0.73 %	536,415	0.48 %	465,403	0.45 %
Certificates and other time	940,356	1.65 %	748,086	1.21 %	648,075	1.09 %
Total interest-bearing deposits	1,802,288	1.22 %	1,441,028	0.85 %	1,217,690	0.78 %
Noninterest-bearing deposits	848,276	—	672,101	—	620,701	—
Total deposits	$2,650,564	0.83 %	$2,113,129	0.58 %	$1,838,391	0.52 %

Our ratio of average noninterest-bearing deposits to average total deposits was 32.0%, 31.8% and 33.8% for the years ended December 31, 2018, 2017 and 2016, respectively.

The following table sets forth the amount of our certificates of deposit that are $100 thousand or greater by time remaining until maturity:

	As of December 31,	
	2018	2017
	(Dollars in thousands)	
Three months or less	$243,169	$144,741
Over three months through six months	164,687	108,535
Over six months through 12 months	298,921	175,588
Over 12 months through three years	219,818	131,244
Over three years	154,389	87,895
Total	$1,080,984	$648,003

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Borrowings

We have an available line of credit with the FHLB of Dallas, which allows us to borrow on a collateralized basis. FHLB advances are used to manage liquidity as needed. The advances are secured by a blanket lien on certain loans. Maturing advances are replaced by drawing on available cash, making additional borrowings or through increased customer deposits. At December 31, 2018, we had a total borrowing capacity of $1.06 billion, of which $765.4 million was available under this agreement and $296.5 million was outstanding. FHLB advances of $225.0 million were outstanding at December 31, 2018, at a weighted average rate of 2.57%. Letters of credit were $71.5 million at December 31, 2018, of which $8.8 million expired in January 2019, $10.2 million expired in February 2019, $7.1 million will expire in April 2019, $7.1 million will expire in May 2019, $5.5 million will expire in August 2019, $25.0 million will expire in October 2019, $6.3 million will expire in December 2019 and $1.5 million will expire in January 2020.

Credit Agreement

In January 2015, we borrowed an additional $18.0 million under our credit agreement with another financial institution, which was in addition to the $10.1 million of indebtedness incurred under the same agreement in 2014. We used the funds borrowed in 2015 to repay debt that F&M Bancshares owed. In October 2015, we paid down $27.5 million on the credit agreement using a portion of the proceeds from the initial public offering of Allegiance common stock. As of December 31, 2018, 2017 and 2016, we had $569 thousand of indebtedness owed under the credit agreement. The interest rate on the outstanding debt under the revolving credit agreement is the Prime Rate minus 25 basis points, or 5.00% at December 31, 2018, and is paid quarterly. On December 28, 2018, we amended the credit agreement to increase the maximum commitment to advance funds to $45.0 million which will reduce annually by $7.5 million beginning in December 2020 and on each December 22nd for the following years thereafter. We are required to repay any outstanding balance in excess of the then-current maximum commitment amount. The revised agreement will mature in December 2025 and is secured by 100% of the capital stock of the Bank.

Our credit agreement contains certain restrictive covenants, including limitations on our ability to incur additional indebtedness or engage in certain fundamental corporate transactions, such as mergers, reorganizations and recapitalizations. Additionally, the Bank is required to maintain a “well-capitalized” rating, a minimum return on assets of 0.65%, measured quarterly, a ratio of loan loss reserve to non-performing loans equal to or greater than 75%, measured quarterly, and a ratio of non-performing assets to aggregate equity plus loan loss reserves minus intangible assets of less than 35%, measured quarterly. As of December 31, 2018, we believe we were in compliance with all such debt covenants and had not been made aware of any noncompliance by the lender.

Subordinated Debt

Junior Subordinated Debentures

In connection with the F&M Bancshares acquisition, we assumed junior subordinated debentures with an aggregate original principal amount of $11.3 million and a current fair value of $9.4 million at December 31, 2018. At acquisition, we recorded a discount of $2.5 million on the debentures. The difference between the carrying value and contractual balance will be recognized as a yield adjustment over the remaining term for the debentures. See Note 11 to our audited consolidated financial statements included elsewhere in this Annual Report on Form 10-K.

Subordinated Notes

In December 2017, the Bank completed the issuance, through a private placement, of $40.0 million aggregate principal amount of Fixed-to-Floating Rate Subordinated Notes (the "Notes") due December 15, 2027. The Notes were issued at a price equal to 100% of the principal amount, resulting in net proceeds to the Bank of $39.4 million.

The Bank used the net proceeds from the offering to support its growth and for general corporate purposes. The Notes are intended to qualify as Tier 2 capital for bank regulatory purposes.

The Notes bear a fixed interest rate of 5.25% per annum until (but excluding) December 15, 2022, payable semi-annually in arrears. From December 15, 2022, the Notes will bear a floating rate of interest equal to 3-Month LIBOR + 3.03% until the Notes mature on December 15, 2027, or such earlier redemption date, payable quarterly in arrears. The Notes will be redeemable by the Bank, in whole or in part, on or after December 15, 2022 or, in whole but not in part, upon the occurrence of certain specified tax events, capital events or investment company events. Any redemption will be at a redemption price equal to 100% of the principal amount of Notes being redeemed, plus accrued and unpaid interest, and will be subject to, and require, prior regulatory approval. The Notes are not subject to redemption at the option of the holders.

Contractual Obligations

The following tables summarize our contractual obligations and other commitments to make future payments as of December 31, 2018 and 2017 (other than deposit obligations), which consist of our future cash payments associated with our contractual obligations pursuant to our non-cancelable operating leases and our indebtedness owed to another financial institution. Payments related to leases are based on actual payments specified in underlying contracts.

	As of December 31, 2018				
	One Year or Less	More than One Year but Less Than Three Years	Three years or More but Less Than Five Years	Five Years or More	Total
	(Dollars in thousands)				
Credit agreement	$—	$ —	$—	$569	$569
Operating leases	2,559	1,987	3,242	5,126	12,914
Total	$2,559	$ 1,987	$3,242	$5,695	$13,483

	As of December 31, 2017				
	One Year or Less	More than One Year but Less Than Three Years	Three years or More but Less Than Five Years	Five Years or More	Total
	(Dollars in thousands)				
Credit agreement	$—	$ —	$—	$569	$569
Operating leases	1,806	1,030	1,950	4,673	9,459
Total	$1,806	$ 1,030	$1,950	$5,242	$10,028

Off-Balance Sheet Items

In the normal course of business, we enter into various transactions, which, in accordance with GAAP, are not included in our consolidated balance sheets. We enter into these transactions to meet the financing needs of our customers. These transactions include both commitments to extend credit and standby and performance letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in our consolidated balance sheets.

Our commitments associated with outstanding standby letters of credit and commitments to extend credit expiring by period are summarized below as of December 31, 2018. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements:

	As of December 31, 2018				
	One Year or Less	More than One Year but Less Than Three Years	Three years or More but Less Than Five Years	Five Years or More	Total
	(Dollars in thousands)				
Commitments to extend credit	$534,388	$ 139,321	$ 38,812	$289,465	$ 1,001,986
Standby letters of credit	21,702	1,529	53	—	23,284
Total	$556,090	$ 140,850	$ 38,865	$289,465	$ 1,025,270

Commitments to Extend Credit. We enter into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of our commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. We minimize our exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures. The amount and type of collateral obtained, if considered necessary by us, upon extension of credit, is based on management's credit evaluation of the customer. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of the allowance for loan losses.

Standby Letters of Credit. Standby letters of credit are written conditional commitments issued by us to guarantee the performance of a customer to a third party. If the customer does not perform in accordance with the terms of the agreement with the third party, we would be required to fund the commitment and we would have the rights to the underlying collateral. The maximum potential amount of future payments we could be required to make is represented by the contractual amount of the commitment. Our policies generally require that standby letter of credit arrangements are backed by promissory notes that contain security and debt covenants similar to those contained in loan agreements.

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Liquidity and Capital Resources

Liquidity

Liquidity is the measure of our ability to meet the cash flow requirements of depositors and borrowers, while at the same time meeting our operating, capital and strategic cash flow needs and to maintain reserve requirements to operate on an ongoing basis and manage unexpected events, all at a reasonable cost. During the years ended December 31, 2018, 2017 and 2016, our liquidity needs have been met by deposits, borrowed funds, security and loan maturities and amortizing investment and loan portfolios. The Bank has access to purchased funds from correspondent banks, and advances from the FHLB are available under a security and pledge agreement to take advantage of investment opportunities.

Average assets totaled $3.37 billion, $2.70 billion and $2.34 billion for the years ended December 31, 2018, 2017 and 2016, respectively. The following table illustrates, during the periods presented, the mix of our funding sources and the average assets in which those funds are invested as a percentage of our average total assets for the period indicated.

	For the Years Ended December 31,		
	2018	2017	2016
Sources of Funds:			
Deposits:			
Noninterest-bearing	25.2 %	24.9 %	26.5 %
Interest-bearing	53.6 %	53.4 %	52.0 %
Borrowed funds	7.2 %	10.0 %	9.0 %
Subordinated debt	1.4 %	0.4 %	0.4 %
Other liabilities	0.3 %	0.3 %	0.4 %
Shareholders’ equity	12.3 %	11.0 %	11.7 %
Total	100.0%	100.0%	100.0%
Uses of Funds:			
Loans	78.8 %	77.1 %	75.1 %
Securities	9.4 %	12.0 %	11.6 %
Deposits in other financial institutions	2.1 %	1.9 %	3.7 %
Noninterest-earning assets	9.7 %	9.0 %	9.6 %
Total	100.0%	100.0%	100.0%
	.		
Average noninterest-bearing deposits to average deposits	32.0 %	31.8 %	33.8 %
Average loans to average deposits	100.1%	98.5 %	95.5 %

Our largest source of funds is deposits and our largest use of funds is loans. Our average loans increased $571.0 million, or 27.4%, for the year ended December 31, 2018 compared to the year ended December 31, 2017. We predominantly invest excess deposits in Federal Reserve Bank of Dallas balances, securities, interest-bearing deposits at other banks or other short-term liquid investments until the funds are needed to fund loan growth. Our securities portfolio had a weighted average life of 6.1 years and modified duration of 5.1 years at December 31, 2018, and a weighted average life of 6.5 years and modified duration of 5.5 years at December 31, 2017.

As of December 31, 2018 and December 31, 2017, we had outstanding $1.00 billion and $620.0 million, respectively, in commitments to extend credit and $23.3 million and $17.2 million, respectively, in commitments associated with outstanding standby and performance letters of credit. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the total outstanding may not necessarily reflect the actual future cash funding requirements.

As of December 31, 2018, 2017 and 2016, we had no exposure to future cash requirements associated with known uncertainties or capital expenditures of a material nature.

As of December 31, 2018, we had cash and cash equivalents of $268.9 million compared with $182.1 million at December 31, 2017, an increase of $86.8 million. This increase in cash and cash equivalents was primarily due to $230.4 million of cash acquired in the Post Oak acquisition.

Capital Resources

Capital management consists of providing equity to support our current and future operations. We are subject to capital adequacy requirements imposed by the Federal Reserve and the Bank is subject to capital adequacy requirements imposed by the FDIC. Both the Federal Reserve and the FDIC have adopted risk-based capital requirements for assessing bank holding companies and bank capital adequacy. These standards define capital and establish minimum capital requirements in relation to assets and off-balance sheet exposure, adjusted for credit risk. The risk-based capital standards currently in effect are designed to make regulatory capital requirements more sensitive to differences in risk profiles among bank holding companies and banks, to account for off-balance sheet exposure and to minimize disincentives for holding liquid assets. Assets and off-balance sheet items are assigned to broad risk categories, each with appropriate relative risk weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items.

Under current guidelines, the minimum ratio of total capital to risk-weighted assets (which are primarily the credit risk equivalents of balance sheet assets and certain off-balance sheet items such as standby letters of credit) is 8.0%. At least half of total capital must be composed of tier 1 capital, which includes common shareholders' equity (including retained earnings), less goodwill, other disallowed intangibles and disallowed deferred tax assets, among other items. The Federal Reserve also has adopted a minimum leverage ratio, requiring tier 1 capital of at least 4.0% of average quarterly total consolidated assets, net of goodwill and certain other intangible assets, for all but the most highly rated bank holding companies. The federal banking agencies have also established risk-based and leverage capital guidelines that FDIC-insured depository institutions are required to meet. These regulations are generally similar to those established by the Federal Reserve for bank holding companies.

Under the Federal Deposit Insurance Act, the federal bank regulatory agencies must take "prompt corrective action" against undercapitalized U.S. depository institutions. U.S. depository institutions are assigned one of five capital categories: "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized," and are subjected to different regulation corresponding to the capital category within which the institution falls. A depository institution is deemed to be "well capitalized" if the banking institution has a total risk-based capital ratio of 10.0% or greater, a tier 1 risk-based capital ratio of 8.0% or greater, a common equity Tier 1 capital ratio of 6.5% and a leverage ratio of 5.0% or greater, and the institution is not subject to an order, written agreement, capital directive or prompt corrective action directive to meet and maintain a specific level for any capital measure. Under certain circumstances, a well-capitalized, adequately capitalized or undercapitalized institution may be treated as if the institution were in the next lower capital category.

Failure to meet capital guidelines could subject the institution to a variety of enforcement remedies by federal bank regulatory agencies, including: termination of deposit insurance by the FDIC, restrictions on certain business activities and appointment of the FDIC as conservator or receiver. As of December 31, 2018, 2017 and 2016, the Bank was well-capitalized.

Basel III Capital Rules impact regulatory capital ratios of banking organizations in the following manner, when fully phased in: create a new requirement to maintain a ratio of "common equity Tier 1 capital" to total risk-weighted assets of not less than 4.5%; increase the minimum leverage capital ratio to 4.0% for all banking organizations; increase the minimum tier 1 risk-based capital ratio from 4.0% to 6.0%; and maintain the minimum total risk-based capital ratio at 8.0%.

In addition, the Basel III Capital Rules subject a banking organization to certain limitations on capital distributions and discretionary bonus payments to executive officers if the organization does not maintain a "capital conservation buffer" of common equity Tier 1 capital. The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and was phased in over a three-year period (increasing by 0.625% on each subsequent January 1, until it reached 2.5% on January 1, 2019). The effect of the capital conservation buffer is to increase the minimum common equity Tier 1 capital ratio to 7.0%, the minimum tier 1 risk-based capital ratio to 8.5% and the minimum total risk-based capital ratio to 10.5%.

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The following table provides a comparison of the Company's and the Bank's leverage and risk-weighted capital ratios as of December 31, 2018 to the minimum and well-capitalized regulatory standards:

	Actual Ratio		Minimum Required for Capital Adequacy Purposes		Minimum Required Plus Capital Conservation Buffer		To Be Categorized As Well Capitalized Under Prompt Corrective Action Provisions	
ALLEGIANCE BANCSHARES, INC.								
(Consolidated)								
Total capital (to risk weighted assets)	13.70	%	8.00	%	9.875	%	N/A	
Common equity Tier 1 capital (to risk weighted assets)	11.76	%	4.50	%	6.375	%	N/A	
Tier 1 capital (to risk weighted assets)	12.01	%	6.00	%	7.875	%	N/A	
Tier 1 capital (to average assets)	10.61	%	4.00	%	4.000	%	N/A	
ALLEGIANCE BANK:								
Total capital (to risk weighted assets)	13.53	%	8.00	%	9.875	%	10.00	%
Common equity Tier 1 capital (to risk weighted assets)	11.83	%	4.50	%	6.375	%	6.50	%
Tier 1 capital (to risk weighted assets)	11.83	%	6.00	%	7.875	%	8.00	%
Tier 1 capital (to average assets)	10.45	%	4.00	%	4.000	%	5.00	%

Total shareholder's equity was $703.0 million at December 31, 2018, compared with $306.9 million at December 31, 2017, an increase of $396.1 million, or 129.1%. This increase was primarily due to common equity issued related to the Post Oak acquisition.

Asset/Liability Management and Interest Rate Risk

Our asset liability and interest rate risk policy provides management with the guidelines for effective balance sheet management. We have established a measurement system for monitoring our net interest rate sensitivity position. We manage our sensitivity position within our established guidelines.

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

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

Our exposure to interest rate risk is managed by our Asset Liability Committee ("ALCO"), which is composed of certain members of our Board of Directors and Bank management, in accordance with policies approved by our Board of Directors. The ALCO formulates strategies based on appropriate levels of interest rate risk. In determining the appropriate level of interest rate risk, the ALCO considers the impact on earnings and capital of the current outlook on interest rates, potential changes in interest rates, regional economies, liquidity, business strategies and other factors. The ALCO meets regularly to review, among other things, the sensitivity of assets and liabilities to interest rate changes, the book and market values of assets and liabilities, unrealized gains and losses, purchase and sale activities, commitments to originate loans and the maturities of investments and borrowings. Additionally, the ALCO reviews liquidity, cash flow flexibility, maturities of deposits and consumer and commercial deposit activity.

We use an interest rate risk simulation model and shock analysis to test the interest rate sensitivity of net interest income and the balance sheet, respectively. All instruments on the balance sheet are modeled at the instrument level, incorporating all relevant attributes such as next reset date, reset frequency and call dates, as well as prepayment assumptions for loans and securities and decay rates for nonmaturity deposits. Assumptions based on past experience are incorporated into the model for nonmaturity deposit account decay rates. The assumptions used are inherently uncertain and, as a result, the model cannot precisely measure future net interest income or precisely predict the impact of fluctuations in market interest rates on net interest income. Actual results will differ from the model's simulated results due to timing, magnitude and frequency of interest rate changes as well as changes in market conditions and the application and timing of various management strategies.

We utilize static balance sheet rate shocks to estimate the potential impact on net interest income of changes in interest rates under various rate scenarios. This analysis estimates a percentage of change in the metric from the stable rate base scenario versus alternative scenarios of rising and falling market interest rates by instantaneously shocking a static balance sheet.

The following table summarizes the simulated change in net interest income and the economic value of equity over a 12-month horizon as of the dates indicated:

Change in Interest Rates (Basis Points)	Percent Change in Net Interest Income		Percent Change in Economic Value of Equity	
	As of December 31, 2018	As of December 31, 2017	As of December 31, 2018	As of December 31, 2017
+300	0.9%	(6.2)%	0.2%	(9.0)%
+200	0.9%	(4.1)%	0.9%	(5.4)%
+100	0.6%	(2.2)%	1.0%	(2.3)%
Base	0.0%	0.0%	0.0%	0.0%
-100	(1.1)%	(1.9)%	(2.7)%	(1.9)%

These results are primarily due to the duration of our loan and securities portfolio, the duration of our borrowings and the expected behavior of demand, money market and savings deposits during such rate fluctuations. During 2018, the overall duration of our combined loan and securities portfolios decreased and FHLB borrowings represented a smaller proportion of our funding mix at year end due primarily to the assets and liabilities acquired in the Post Oak acquisition.

GAAP Reconciliation and Management's Explanation of Non-GAAP Financial Measures

We identify certain financial measures discussed in this Annual Report on Form 10-K as being "non-GAAP financial measures." In accordance with the SEC's rules, we classify a financial measure as being a non-GAAP financial measure if that financial measure excludes or includes amounts, or is subject to adjustments that have the effect of excluding or including amounts, that are included or excluded, as the case may be, in the most directly comparable measure calculated and presented in accordance with generally accepted accounting principles as in effect from time to time in the United States in our statements of income, balance sheet or statements of cash flows. Non-GAAP financial measures do not include operating and other statistical measures or ratios or statistical measures calculated using exclusively either financial measures calculated in accordance with GAAP, operating measures or other measures that are not non-GAAP financial measures or both.

The non-GAAP financial measures that we discuss in this Annual Report on Form 10-K should not be considered in isolation or as a substitute for the most directly comparable or other financial measures calculated in accordance with GAAP. Moreover, the manner in which we calculate the non-GAAP financial measures that we discuss in this Annual Report on Form 10-K may differ from that of other companies reporting measures with similar names. You should understand how such other banking organizations calculate their financial measures similar or with names similar to the non-GAAP financial measures we have discussed in this Annual Report on Form 10-K when comparing such non-GAAP financial measures.

Our management uses these non-GAAP financial measures in its analysis of our performance:

- "Tangible Shareholders' Equity" is a non-GAAP measure generally used by financial analysts and investment bankers to evaluate financial institutions. Tangible shareholders' equity is defined as total shareholders' equity reduced by goodwill and core deposit intangibles, net of accumulated amortization. This measure is important to investors interested in changes from period to period in shareholders' equity, exclusive of changes in intangible assets. For tangible shareholders' equity, the most directly comparable financial measure calculated in accordance with GAAP is total shareholders' equity. Goodwill and other intangible assets have the effect of increasing total shareholders' equity while not increasing our tangible equity.
- "Tangible Book Value Per Share" is a non-GAAP measure generally used by financial analysts and investment bankers to evaluate financial institutions. Tangible book value per share is defined as total shareholders' equity reduced by goodwill and core deposit intangibles, net of accumulated amortization, divided by total shares outstanding. This measure is important to investors interested in changes from period to period in book value per share, exclusive of changes in intangible assets. For tangible book value per share, the most directly comparable financial measure calculated in accordance with GAAP is our book value per share.
- "Tangible Equity to Tangible Assets" is a non-GAAP measure generally used by financial analysts and investment bankers to evaluate financial institutions. Tangible equity to tangible assets is defined as total shareholders' equity reduced

by goodwill and core deposit intangibles, net of accumulated amortization, divided by tangible assets, which are total assets reduced by goodwill and core deposit intangibles, net of accumulated amortization. This measure is important to investors interested in changes from period to period in equity and total assets, each exclusive of changes in intangible assets. For tangible equity to tangible assets, the most directly comparable financial measure calculated in accordance with GAAP is total shareholders' equity to total assets. Goodwill and other intangible assets have the effect of increasing both total shareholders' equity and assets while not increasing our tangible common equity or tangible assets.

We believe these non-GAAP financial measures provide useful information to management and investors that is supplementary to our financial condition, results of operations and cash flows computed in accordance with GAAP; however, we acknowledge that our non-GAAP financial measures have a number of limitations. As such, you should not view these disclosures as a substitute for results determined in accordance with GAAP, and they are not necessarily comparable to non-GAAP financial measures that other companies use. The following reconciliation tables provide a more detailed analysis of these non-GAAP financial measures:

	As of and for the Years Ended December 31,				
	2018	2017	2016	2015	2014
	(Dollars in thousands, except share and per share data)				
Total shareholders' equity	$702,984	$306,865	$279,817	$258,490	$131,778
Less:					
Goodwill and core deposit intangibles, net	249,712	42,663	43,444	44,619	12,891
Tangible shareholders' equity	$453,272	$264,202	$236,373	$213,871	$118,887
Shares outstanding at end of period[1]	21,937,740	13,226,826	12,958,341	12,812,985	7,477,309
Tangible book value per share	$20.66	$19.97	$18.24	$16.69	$15.90
Net income attributable to shareholders	$37,309	$17,632	$22,851	$15,227	$9,005
Average shareholders' equity	$413,441	$297,627	$273,211	$204,935	$116,460
Less:					
Average goodwill and other intangible assets, net	80,384	43,050	43,880	45,055	13,007
Average tangible common shareholders' equity	$333,057	$254,577	$229,331	$159,880	$103,453
Return on average tangible common equity	11.20 %	6.93 %	9.96 %	9.52 %	8.70 %
Total assets	$4,655,249	$2,860,231	$2,450,948	$2,084,579	$1,280,008
Less:					
Goodwill and core deposit intangibles, net	249,712	42,663	43,444	44,619	12,891
Tangible assets	$4,405,537	$2,817,568	$2,407,504	$2,039,960	$1,267,117
Tangible common equity to tangible assets	10.29 %	9.38 %	9.82 %	10.48 %	9.38 %

(1) Does not include 1,711 shares of treasury stock as of December 31, 2015. There were no shares of treasury stock outstanding as of December 31, 2018, 2017, 2016 or 2014.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For information regarding the market risk of the Company's financial instruments, see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operation—Financial Condition—Asset/Liability Management and Interest Rate Risk." Our principal market risk exposure is to changes in interest rates.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements, the reports thereon, the notes thereto and supplementary data commence at page 72 of this Annual Report on Form 10-K.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. As of the end of the period covered by this Annual Report on Form 10-K, the Company carried out an evaluation, under the supervision and with the participation of its management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply judgment in evaluating its controls and procedures. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) were effective as of the end of the period covered by this report. See Exhibits 31.1 and 31.2 for the Certification statements issued by the Company's Chief Executive Officer and Chief Financial Officer, respectively.

Changes in Internal Control over Financial Reporting. There were no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the year ended December 31, 2018, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Reporting on Management's Assessment of Internal Controls over Financial Reporting. Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Our internal control system is a process designed to provide reasonable assurance regarding the preparation and fair presentation of published financial statements in accordance with GAAP. All internal control systems, no matter how well designed, have inherent limitations and can only provide reasonable assurance with respect to financial reporting.

As of December 31, 2018, management assessed the effectiveness of the Company's internal control over financial reporting based on the criteria for effective internal control over financial reporting established in "Internal Control-Integrated Framework," issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. Based on this assessment, management determined that the Company maintained effective internal control over financial reporting as of December 31, 2018.

Crowe LLP, the independent registered public accounting firm, audited the consolidated financial statements of the Company included in this Annual Report on Form 10-K. Their report is included in Part IV, Item 15. under the heading "Report of Independent Registered Public Accounting Firm." Pursuant to SEC rules applicable to emerging growth companies, this Annual Report on Form 10-K does not include an attestation report on management's assessment of internal control over financial reporting from the Company's independent registered public accounting firm.

ITEM 9B. OTHER INFORMATION

None.

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PART III.

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item is incorporated herein by reference to the Company's definitive Proxy Statement for its 2019 Annual Meeting of Shareholders (the "2019 Proxy Statement") to be filed with the SEC pursuant to Regulation 14A under the Exchange Act within 120 days of the Company's fiscal year end.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated herein by reference to the 2019 Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

Certain information required by this Item is included under "Securities Authorized for Issuance under Equity Compensation Plans" in Part II, Item 5 of this Annual Report on Form 10-K. The other information required by this Item is incorporated herein by reference to the 2019 Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated herein by reference to the 2019 Proxy Statement.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item is incorporated herein by reference to the 2019 Proxy Statement.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as part of this Annual Report on Form 10-K:

1. Consolidated Financial Statements. Reference is made to the Consolidated Financial Statements, the report thereon and the notes thereto commencing at page 72 of this Annual Report on Form 10-K. Set forth below is a list of such Consolidated Financial Statements:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2018 and 2017

Consolidated Statements of Income for the Years Ended December 31, 2018, 2017, and 2016

Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2018, 2017 and 2016

Consolidated Statements of Changes in Shareholders' Equity for the Years Ended December 31, 2018, 2017 and 2016

Consolidated Statements of Cash Flows for the Years Ended December 31, 2018, 2017 and 2016

Notes to Consolidated Financial Statements

2. Financial Statement Schedules. All supplemental schedules are omitted as inapplicable or because the required information is included in the Consolidated Financial Statements or notes thereto.

3. The exhibits to this Annual Report on Form 10-K listed below have been included only with the copy of this report filed with the SEC. The Company will furnish a copy of any exhibit to shareholders upon written request to the Company and payment of a reasonable fee not to exceed the Company's reasonable expense.

Each exhibit marked with an asterisk is filed or furnished with this Annual Report on Form 10-K as noted below.

Exhibit Number	Description
2.1	Agreement and Plan of Reorganization by and between Allegiance Bancshares, Inc. and Post Oak Bancshares, Inc. dated April 30, 2018 (incorporated herein by reference to Exhibit 2.1 to the Company's Form 8-K filed on May 1, 2018)
3.1	Amended and Restated Certificate of Formation of Allegiance Bancshares, Inc. (incorporated herein by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q filed on November 1, 2018)
3.2	Bylaws of Allegiance Bancshares, Inc. (incorporated herein by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 (Registration No. 333-206536) (the "Registration Statement")
4.1	Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 to the Registration Statement)

4.2	Form of Fixed-to-Floating Rate Subordinated Note due December 15, 2027 Certificate (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on December 14, 2017)
10.1	Tax Allocation Agreement dated April 1, 2013, by and between Allegiance Bancshares, Inc. and Allegiance Bank (f/k/a Allegiance Bank Texas) (incorporated by reference to Exhibit 10.1 to the Registration Statement)
10.2	Allegiance Bancshares, Inc. 2015 Amended and Restated Stock Awards and Incentive Plan (including form of awards) (incorporated by reference to Exhibit 10.2 to the Registration Statement)
10.3	Credit Agreement dated as of December 22, 2014 by and among Allegiance Bancshares, Inc. and Prosperity Bank (incorporated by reference to Exhibit 10.3 to the Registration Statement)
10.4	Form of Director and Officer Indemnification Agreement (incorporated by reference to Exhibit 10.4 to Amendment No. 1 to the Registration Statement)
10.5	Amendment to the Allegiance Bancshares, Inc. 2015 Amended and Restated Stock Awards and Incentive Plan (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on May 24, 2017)

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10.6	Allegiance Bancshares, Inc. Form of Non-Employee Director Restricted Stock Agreement (incorporated by reference to Exhibit 10.1 to the Company’s Quarterly Report on Form 10-Q filed on May 5, 2017)
10.7	Amended and Restated Employee Stock Purchase Plan (incorporated by reference to Exhibit 99.1 to the Company's Registration Statement on Form S-8 (Registration No. 333-208600))
10.8	Amendment to Amended and Restated Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.8 to the Company’s Annual Report on Form 10-K filed on March 9, 2018)
10.9	Amendment No. 1 to Credit Agreement, dated as of December 28, 2018, by and among Allegiance Bancshares, Inc. and Prosperity Bank (incorporated by reference to Exhibit 10.1 to the Company’s Current Report on Form 8-K filed on December 31, 2018)
10.10	Allegiance Bancshares, Inc. Annual Incentive Plan (incorporated by reference to Exhibit 10.1 to the Company’s Current Report on Form 8-K filed on January 29, 2019)
21.1*	Subsidiaries of Allegiance Bancshares, Inc.
23.1*	Consent of Crowe LLP
31.1*	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
31.2*	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
32.1**	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2**	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document Exhibit
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

EXHIBITS

*Filed with this Annual Report on Form 10-K.
**Furnished with this Annual Report on Form 10-K.

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant, has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 11, 2019

ALLEGIANCE BANCSHARES, INC.

By: /s/ George Martinez
George Martinez
Chairman and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Positions	Date
/s/ George Martinez George Martinez	Chairman and Chief Executive Officer (Principal Executive Officer); Director	March 11, 2019
/s/ Steven F. Retzloff Steven F. Retzloff	Director	March 11, 2019
/s/ Paul P. Egge Paul P. Egge	Chief Financial Officer (Principal Financial and Principal Accounting Officer)	March 11, 2019
/s/ Ramon A. Vitulli, III Ramon A. Vitulli, III	Director	March 11, 2019
/s/ John Beckworth John Beckworth	Director	March 11, 2019
/s/ Matthew H. Hartzell Matthew H. Hartzell	Director	March 11, 2019
/s/ Robert Ivany Robert Ivany	Director	March 11, 2018
/s/ Umesh Jain Umesh Jain	Director	March 11, 2019
/s/ Frances H. Jeter Frances H. Jeter	Director	March 11, 2019
/s/ James J. Kearney	Director	March 11, 2019

James J. Kearney

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Signature	Positions	Date
/s/ P. Michael Mann, M.D. P. Michael Mann, M.D.	Director	March 11, 2019
/s/ Robert E. McKee III Robert E McKee III	Director	March 11, 2019
/s/ David B. Moulton David B. Moulton	Director	March 11, 2019
/s/ William S. Nichols, III William S. Nichols, III	Director	March 11, 2019
/s/ Thomas A. Reiser Thomas A. Reiser	Director	March 11, 2019
/s/ Raimundo Riojas E. Raimundo Riojas E.	Director	March 11, 2019
/s/ Fred S. Robertson Fred S. Robertson	Director	March 11, 2019
/s/ Louis A. Waters Jr. Louis A. Waters Jr.	Director	March 11, 2019
/s/ Roland L. Williams Roland L. Williams	Director	March 11, 2019

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Shareholders and the Board of Directors of

Allegiance Bancshares, Inc.

Houston, Texas

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Allegiance Bancshares, Inc. (the "Company") as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2018, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Crowe LLP

We have served as the Company's auditor since 2014.

Dallas, Texas

March 11, 2019

ALLEGIANCE BANCSHARES, INC.

CONSOLIDATED BALANCE SHEETS

	December 31, 2018	2017
	(Dollars in thousands, except share data)	
ASSETS		
Cash and due from banks	$118,771	$133,124
Interest-bearing deposits at other financial institutions	150,176	48,979
Total cash and cash equivalents	268,947	182,103
Available for sale securities, at fair value	337,293	309,615
Loans held for investment	3,708,306	2,270,876
Less: allowance for loan losses	(26,331)	(23,649)
Loans, net	3,681,975	2,247,227
Accrued interest receivable	17,010	12,194
Premises and equipment, net	41,717	18,477
Other real estate owned	630	365
Federal Home Loan Bank stock	10,941	12,862
Bank owned life insurance	26,480	22,422
Goodwill	223,125	39,389
Core deposit intangibles, net	26,587	3,274
Other assets	20,544	12,303
TOTAL ASSETS	$4,655,249	$2,860,231
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	$1,209,300	$683,110
Interest-bearing		
Demand	366,905	215,499
Money market and savings	879,840	554,051
Certificates and other time	1,206,491	761,314
Total interest-bearing deposits	2,453,236	1,530,864
Total deposits	3,662,536	2,213,974
Accrued interest payable	2,812	610
Borrowed funds	225,493	282,569
Subordinated debt	48,899	48,659
Other liabilities	12,525	7,554
Total liabilities	3,952,265	2,553,366
COMMITMENTS AND CONTINGENCIES (See Note 15)		
SHAREHOLDERS' EQUITY:		
Preferred stock, $1 par value; 1,000,000 shares authorized; there were no shares issued or outstanding	—	—
Common stock, $1 par value; 80,000,000 shares authorized; 21,937,740 shares outstanding at December 31, 2018 and 13,226,826 shares issued	21,938	13,227

and outstanding at December 31, 2017		
Capital surplus	571,803	218,408
Retained earnings	112,131	74,894
Accumulated other comprehensive (loss) income	(2,888)	336
Total shareholders' equity	702,984	306,865
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$4,655,249	$2,860,231

See notes to consolidated financial statements.

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ALLEGIANCE BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF INCOME

	For the Years Ended December 31,		
	2018	2017	2016
	(Dollars in thousands, except per share data)		
INTEREST INCOME:			
Loans, including fees	$148,223	$110,331	$93,356
Securities:			
Taxable	2,725	2,111	1,807
Tax-exempt	5,802	6,334	5,044
Deposits in other financial institutions	1,473	662	571
Total interest income	158,223	119,438	100,778
INTEREST EXPENSE:			
Demand, money market and savings deposits	6,478	3,159	2,437
Certificates and other time deposits	15,478	9,060	7,044
Borrowed funds	4,788	2,922	945
Subordinated debt	2,900	629	488
Total interest expense	29,644	15,770	10,914
NET INTEREST INCOME	128,579	103,668	89,864
Provision for loan losses	4,248	13,188	5,469
Net interest income after provision for loan losses	124,331	90,480	84,395
NONINTEREST INCOME:			
Nonsufficient funds fees	755	685	661
Service charges on deposit accounts	869	783	677
Gain on sale of branch assets	—	—	2,050
Gain on sale of securities	—	18	30
(Loss) gain on sales of other real estate and other repossessed assets	(428)	6	266
Bank owned life insurance income	579	585	626
Rebate from correspondent bank	2,609	1,327	650
Other	3,329	2,457	2,308
Total noninterest income	7,713	5,861	7,268
NONINTEREST EXPENSE:			
Salaries and employee benefits	56,704	44,745	38,858
Net occupancy and equipment	5,845	5,452	4,944
Depreciation	2,132	1,637	1,627
Data processing and software amortization	5,120	4,047	2,633
Professional fees	2,009	2,926	2,234
Regulatory assessments and FDIC insurance	2,309	2,273	1,581
Core deposit intangibles amortization	1,815	781	785
Communications	1,185	983	1,055
Advertising	1,725	1,289	945
Acquisition and merger-related expenses	1,661	—	—
Other	6,282	5,829	4,596
Total noninterest expense	86,787	69,962	59,258
INCOME BEFORE INCOME TAXES	45,257	26,379	32,405

Provision for income taxes	7,948	8,747	9,554
NET INCOME	$37,309	$17,632	$22,851
EARNINGS PER SHARE:			
Basic	$2.41	$1.34	$1.78
Diluted	$2.37	$1.31	$1.75

See notes to consolidated financial statements.

ALLEGIANCE BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	For the Years Ended December 31,		
	2018	2017	2016
	(Dollars in thousands)		
Net income	$37,309	$17,632	$22,851
Other comprehensive (loss) income, before tax:			
Unrealized (loss) gain on securities:			
Change in unrealized holding (loss) gain on available for sale securities during the period	(4,152)	5,213	(7,799)
Reclassification of amount realized through the sale of securities	—	(18)	(30)
Total other comprehensive (loss) income	(4,152)	5,195	(7,829)
Deferred tax benefit (expense) related to other comprehensive income	928	(1,807)	2,760
Other comprehensive (loss) income, net of tax	(3,224)	3,388	(5,069)
Comprehensive income	$34,085	$21,020	$17,782

See notes to consolidated financial statements.

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ALLEGIANCE BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Common Stock		Capital	Retained	Accumulated Other Comprehensive Income	Treasury	Total Shareholders'
	Shares	Amount	Surplus	Earnings	(Loss)	Stock	Equity
	(In thousands, except share data)						
BALANCE AT JANUARY 1, 2016	12,814,696	$12,815	$209,285	$34,411	$ 2,017	$ (38)	$ 258,490
Net income				22,851			22,851
Other comprehensive loss					(5,069)		(5,069)
Common stock issued in connection with the exercise of stock options, restricted stock awards and the ESPP	143,645	143	1,863				2,006
Issuance of treasury stock						38	38
Stock based compensation expense			1,501				1,501
BALANCE AT DECEMBER 31, 2016	12,958,341	$12,958	$212,649	$57,262	$ (3,052)	$ —	$ 279,817
Net income				17,632			17,632
Other comprehensive income					3,388		3,388
Common stock issued in connection with the exercise of stock options, restricted stock awards and the ESPP	268,485	269	3,979				4,248
Stock based compensation expense			1,780				1,780
BALANCE AT DECEMBER 31, 2017	13,226,826	$13,227	$218,408	$74,894	$ 336	$ —	$ 306,865
Net income				37,309			37,309
Other comprehensive loss					(3,224)		(3,224)
Reclassification of amounts within AOCI to retained earnings due to tax				(72)			(72)

reform							
Common stock issued in connection with the exercise of stock options, restricted stock awards and the ESPP	378,023	378	3,372				3,750
Common stock issued in connection with the acquisition of Post Oak Bancshares, Inc., net of registration expenses	8,402,010	8,402	350,381				358,783
Repurchase of common stock	(69,389)	(69)	(2,043)				(2,112)
Stock based compensation expense			1,685				1,685
BALANCE AT DECEMBER 31, 2018	21,937,470	$21,938	$571,803	$112,131	$ (2,888)	$ —	$ 702,984

See notes to consolidated financial statements.

ALLEGIANCE BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,		
	2018	2017	2016
	(Dollars in thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$37,309	$17,632	$22,851
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and core deposit intangibles amortization	3,947	2,418	2,412
Provision for loan losses	4,248	13,188	5,469
Gain on the sale of securities	-	(18)	(30)
Deferred income tax (benefit) expense	(256)	427	(1,608)
Net amortization of premium on investments	3,533	3,427	2,785
Excess tax benefit related to the exercise of stock options	(587)	(1,149)	(371)
Bank owned life insurance	(579)	(585)	(626)
Net accretion of discount on loans	(2,702)	(632)	(1,487)
Net amortization of discount on subordinated debt	110	108	107
Net amortization of discount on certificates of deposit	(367)	(3)	(247)
Net loss (gain) on sale or write down of premises, equipment and other real estate	428	(6)	(60)
Net gain on sale of branch assets	—	—	(2,050)
Federal Home Loan Bank stock dividends	(396)	(273)	(101)
Stock based compensation expense	1,685	1,780	1,501
Increase in accrued interest receivable and other assets	(2,136)	(6,018)	(259)
Increase (decrease) in accrued interest payable and other liabilities	1,822	3,136	(851)
Net cash provided by operating activities	46,059	33,432	27,435
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from maturities and principal paydowns of available for sale securities	2,328,864	2,007,842	2,566,082
Proceeds from sales of available for sale securities	12,701	39,125	2,500
Purchase of available for sale securities	(2,334,149)	(2,038,323)	(2,730,524)
Net change in total loans	(270,314)	(386,059)	(229,286)
Purchase of bank premises and equipment	(3,419)	(2,133)	(1,511)
Proceeds from sale of bank premises, equipment and other real estate	—	1,138	—
Net redemptions (purchases) of Federal Home Loan Bank stock	4,746	586	(10,505)
Net cash paid for the sale of branch assets	—	—	(5,250)
Net cash and cash equivalents acquired in the purchase of Post Oak Bancshares, Inc.	230,416	—	—
Net cash used in investing activities	(31,155)	(377,824)	(408,494)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net increase (decrease) in noninterest-bearing deposits	93,053	89,359	(20,041)

Net increase in interest-bearing deposits	64,566	254,435	157,723
Net change in short-term borrowings	(87,076)	(3,000)	235,000
Proceeds from subordinated notes issuance	—	39,355	—
Proceeds from the issuance of common stock, stock option exercises, restricted stock awards and the ESPP	3,750	4,248	2,006
Cash paid for fractional shares related to the Post Oak acquisition	(21)	—	—
Registration expenses related to common stock issued in the Post Oak acquisition	(220)	—	—
(Repurchase) issuance of treasury stock	(2,112)	—	38
Net cash provided by financing activities	71,940	384,397	374,726
NET CHANGE IN CASH AND CASH EQUIVALENTS	86,844	40,005	(6,333)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	182,103	142,098	148,431
CASH AND CASH EQUIVALENTS, END OF PERIOD	$268,947	$182,103	$142,098
SUPPLEMENTAL INFORMATION:			
Income taxes paid	$6,650	$7,850	$11,400
Interest paid	27,442	15,442	10,500

See notes to consolidated financial statements.

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ALLEGIANCE BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING POLICIES

Nature of Operations and Principles of Consolidation-The consolidated financial statements include Allegiance Bancshares, Inc. (“Allegiance”) and its wholly-owned subsidiary, Allegiance Bank (the “Bank”, and together with Allegiance, collectively referred to as the “Company”) provide commercial and retail loans and commercial banking services. Intercompany transactions and balances are eliminated in consolidation under U.S. generally accepted accounting principles (“GAAP”). The Company derives substantially all of its revenues and income from the operation of the Bank. Allegiance Bank is a Texas banking association which began operations in October 2007. The Company is focused on delivering a wide variety of relationship-driven commercial banking products and community-oriented services tailored to meet the needs of small to mid-sized businesses, professionals and individuals through its 28 offices, with 27 bank offices and one loan production office in the Houston metropolitan area and one office in Beaumont, just outside of the Houston metropolitan area, as of the year ended December 31, 2018. The Bank provides its customers with a variety of banking services including checking accounts, savings accounts and certificates of deposit and its primary lending products are commercial, personal, automobile, mortgage and home improvement loans. The Bank also offers safe deposit boxes, automated teller machines, drive-through services and 24-hour depository facilities.

Use of Estimates—The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions based on available information. These estimates and assumptions affect the reporting of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Acquisition – On October 1, 2018, Allegiance completed the acquisition of Post Oak Bancshares, Inc. See Note 2 – Acquisitions for additional information pertaining to the Post Oak acquisition and the impact of the transaction on the Company’s consolidated financial statements.

Cash and cash equivalents—Cash and cash equivalents include cash, deposits with other financial institutions with maturities not greater than one year. Net cash flows are reported for customer loan and deposit transactions.

Securities—Debt securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value. Unrealized gains and losses are excluded from earnings and reported, net of tax, as a separate component of shareholders’ equity until realized. Securities within the available for sale portfolio may be used as part of the Company’s asset/liability strategy and may be sold in response to changes in interest rate risk, prepayment risk or other similar economic factors.

Interest earned on these assets is included in interest income. Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

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

Loans Held for Investment—Loans held for investment are those that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs, and an allowance for loan losses. Loans are typically secured by specific items of collateral including business assets, consumer assets and commercial and residential real estate. Commercial loans are expected to be repaid from cash flow from operations of businesses. Interest income is accrued on the unpaid principal balance.

Acquired Loans—Acquired loans are recorded at fair value at the date of acquisition with no initial valuation allowance based on a discounted cash flow methodology that considers various factors including the type of loan and related collateral, classification status, fixed or variable interest rate, term of loan and whether or not the loan was amortizing, and a discount rate reflecting the Company's assessment of risk inherent in the cash flow estimates. Certain larger purchased loans are individually evaluated while certain purchased loans are grouped together according to similar risk characteristics and are treated in the aggregate when applying

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various valuation techniques. These cash flow evaluations are inherently subjective as they require material estimates, all of which may be susceptible to significant change.

Loans acquired in a business combination that have evidence of deterioration of credit quality since origination and for which it is probable, at acquisition, that the Company will be unable to collect all contractually required payments receivable are considered purchased credit impaired (“PCI”). PCI loans are individually evaluated and recorded at fair value at the date of acquisition with no initial valuation allowance based on a discounted cash flow methodology that considers various factors including the type of loan and related collateral, classification status, fixed or variable interest rate, term of loan and whether or not the loan was amortizing, and a discount rate reflecting the Company’s assessment of risk inherent in the cash flow estimates. Increases in expected cash flows, including prepayments, subsequent to the initial investment are recognized prospectively through adjustment of the yield on the loan over its remaining life. Decreases in expected cash flows are recognized as impairment. Valuation allowances on PCI loans reflect only losses incurred after the acquisition (meaning the present value of all cash flows expected at acquisition that ultimately are not to be received).

For acquired loans not deemed credit-impaired at acquisition, the differences between the initial fair value and the unpaid principal balance are recognized as interest income on a level-yield basis over the lives of the related loans. Subsequent to the acquisition date, methods utilized to estimate the required allowance for loan losses for these loans is similar to originated loans; however, a provision for credit losses will be recorded only to the extent the required allowance exceeds any remaining purchase discounts. Once an acquired loan undergoes new underwriting and meets the criteria for a new loan, such as in the case of a loan renewal, any remaining fair value adjustments are accreted into interest income and the loan establishes a new amortized cost basis that is fully subject to the Company's allowance for loan loss methodology.

Nonrefundable Fees and Costs Associated with Lending Activities— Loan commitment and loan origination fees, and certain direct origination costs, are deferred and recognized in interest income as an adjustment to yield without anticipating prepayments using the interest method over the related loan life or; if the commitment expires unexercised, balances are recognized in income upon expiration of the commitment.

Nonperforming and Past Due Loans—The Company has several procedures in place to assist it in maintaining the overall quality of its loan portfolio. The Company has established underwriting guidelines to be followed by its officers, and monitors its delinquency levels for any negative or adverse trends. There can be no assurance, however, that the Company’s loan portfolio will not become subject to increasing pressures from deteriorating borrower credit due to general economic conditions or other factors.

Past due status is based on the contractual terms of the loan. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. The Company generally classifies a loan as nonperforming, automatically places the loan on nonaccrual status, ceases accruing interest and reverses all unpaid accrued interest against interest income, when, in management’s opinion, the borrower may be unable to meet payment obligations, when the payment of principal or interest on a loan is delinquent for 90 days, as well as when required by regulatory provisions, unless the loan is in the process of collection and the underlying collateral fully supports the carrying value of the loan. Any payments received on nonaccrual loans are applied first to outstanding loan amounts. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Any excess is treated as recovery of lost interest. Loans are returned to accrual status when all of the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. If the decision is made to continue accruing interest on the loan, periodic reviews are made to confirm the accruing status of the loan. Nonaccrual loans and loans past due 90 days include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. When available information confirms that specific loans, or portions thereof, are uncollectible, these amounts are charged-off against the allowance. All loan types are considered delinquent after 30 days past due and are typically charged-off or charged-down no later than 120 days past due, with consideration of, but not limited to, the following criteria in determining the need and optional timing of the charge-off or charge-down: (1) the Bank is in the process of repossession or foreclosure and there appears to be a likely deficiency, (2) the collateral securing the loan has been sold and there is an actual deficiency, (3) the Bank is proceeding with lengthy legal action to collect its balance, (4) the borrower is unable to be located or (5) the borrower has filed bankruptcy. Charge-offs occur when the Company confirms a loss on a loan.

Troubled debt restructurings (TDRs)—Loans on which terms have been modified resulting in a concession have been granted because of a borrower's financial difficulty are considered troubled debt restructurings and classified as impaired. The restructuring of a loan is considered a troubled debt restructuring if both (1) the borrower is experiencing financial difficulties and (2) the creditor has granted a concession that it would not otherwise consider. Concessions may include reductions of interest rates to a below market interest rate: extension of the terms of the debt, principal forgiveness, restructuring the payment of the debt obligation; and other actions intended to minimize potential losses. Subsequent to identification as a troubled debt restructuring such loans are then evaluated for impairment on an individual basis whereby the loans are measured at the present value of estimated future cash flows

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using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan: the loan is reported, net, at the fair value of the collateral.

Impaired Loans—On a continuous basis, loans are evaluated for impairment classification. Loans are considered impaired when based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on case-by-case basis taking into consideration all of the circumstances surrounding the loan and the borrower including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed.

Allowance for Loan Losses—The allowance for loan losses is a valuation allowance that is established through charges to earnings in the form of a provision for loan losses. The amount of the allowance for loan losses is affected by the following: (1) charge-offs of loans that decrease the allowance, (2) subsequent recoveries on loans previously charged off that increase the allowance and (3) provisions for loan losses charged to income that increase the allowance.

Throughout the year, management estimates the probable incurred losses in the loan portfolio to determine if the allowance for loan losses is adequate to absorb such losses. The allowance for loan losses consists of specific and general components. The specific component relates to loans that are individually classified as impaired. The Company follows a loan review program to evaluate the credit risk in the loan portfolio. Loans that have been identified as impaired are generally reviewed on a quarterly basis in order to determine whether a specific reserve is required. The general component covers non-impaired loans and is based on industry and Company specific historical loan loss experience, volume, growth and composition of the loan portfolio, the evaluation of the Company's loan portfolio through its internal loan review process, general current economic conditions both internal and external to the Company that may affect the borrower's ability to pay, value of collateral and other qualitative relevant risk factors. Based on a review of these estimates, the allowance for loan losses is adjusted to a level determined to be adequate. Estimates of loan losses are inherently subjective as it involves an exercise of judgment. It is the judgment of management that the allowance for loan losses reflected in the consolidated balance sheets is adequate to absorb probable losses that exist in the loan portfolio as of the reporting date.

For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses. The Company assesses the exposure for each modification, either by collateral discounting or by calculation of the present value of future cash flows, and determines if a specific allocation to the allowance for loan losses is needed. Once an obligation has been restructured because of such credit problems, it continues to be considered a troubled debt restructuring until paid in full. The Company returns troubled debt restructurings to accrual status only if (1) all contractual amounts due can reasonably be expected to be repaid within a prudent period and (2) repayment has been in accordance with the contract for a sustained period, typically at least twelve months.

Loans acquired in business combinations are initially recorded at fair value, which includes an estimate of loan losses expected to be realized over the remaining lives of the loans. Therefore no corresponding allowance for loan losses is recorded for these loans at acquisition. Methods utilized to estimate any subsequently required allowance for loan losses for acquired loans not deemed credit-impaired at acquisition are similar to originated loans. However, the estimate of loss is based on the unpaid principal balance and then compared to any remaining unaccreted purchase discount. To the extent that the calculated loss is greater than the remaining unaccreted purchase discount, an allowance is recorded for such difference.

Premises and Equipment—Premises and equipment are carried at cost less accumulated depreciation. Depreciation expense is calculated principally using the straight-line method over the estimated useful lives of the assets which range from 3 to 40 years. Leasehold improvements are amortized using the straight-line method over the periods of the leases or the estimated useful lives, whichever is shorter. Land is carried at cost.

Other Real Estate Owned—Assets acquired through or instead of loan foreclosure are held for sale and are initially recorded at fair value less estimated selling costs when acquired, establishing a new cost basis. Costs after acquisition are generally expensed. If the fair value of the asset declines, a write-down is recorded through expense. The valuation of foreclosed assets is subjective in nature and may be adjusted in the future because of changes in economic conditions. At December 31, 2018, the $630 thousand balance of other real estate owned was a residential real estate property.

Federal Home Loan Bank (“FHLB”) Stock—The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors and may invest in additional amounts. FHLB stock is

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carried at cost, classified as a restricted security and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Bank Owned Life Insurance—The Company purchased bank owned life insurance policies on certain key executives and acquired life insurance policies in conjunction with the acquisitions of F&M Bancshares and Post Oak. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value, which is the most reasonable estimate of fair value, adjusted for other charges or other amounts due that are probable at settlement.

Goodwill—Goodwill resulting from business combinations is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date.

Goodwill is determined to have an indefinite useful life and is not amortized, but is tested for impairment at least annually or more frequently if events and circumstances exists that indicate that a goodwill impairment test should be performed. The Company performs its annual impairment test on October 1. Goodwill is the only intangible asset with an indefinite life on the Company’s balance sheet.

Core Deposit Intangibles—Core deposit and acquired customer relationship intangibles arising from acquisitions are amortized using a straight-line amortization method over their estimated useful lives, which is seven to ten years.

Borrowed Funds—The Company has a credit agreement with another financial institution. The Company pledged its shares in the Bank’s stock as collateral for the borrowing.

Loan Commitments and Related Financial Instruments—Financial instruments include off-balance sheet credit instruments, such as commitments to extend credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Stock Based Compensation—Compensation cost is recognized for stock options and restricted stock awards issued to employees, based on the fair value of these awards at the date of grant. The expense associated with stock based compensation is recognized over the required service period, generally defined as the vesting period of each individual arrangement. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

The fair value of stock options granted and employee stock purchase plan awards are estimated at the date of grant using the Black-Scholes option-pricing model and the market price of the Company’s common stock on the date prior to the grant date is used to value restricted stock awards.

Employee Stock Purchase Plan—The cost of shares issued in the ESPP, but not allocated to participants, is shown as a reduction of shareholder’s equity. Compensation expense is based on the market price of the shares as they are committed to be released to participant accounts.

Income Taxes—Income tax expense is the total of the current year income tax due and the change in deferred tax assets or liabilities. Deferred tax assets and liabilities are recognized for the estimated tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and are recorded in other assets on the Company's consolidated balance sheets.

The Company records uncertain tax positions on the basis of a two-step process whereby (1) the Company determines whether it is more likely than not that the tax positions will be sustained on the basis of the technical merits of the position and (2) for those tax positions that meet the more likely than not recognition threshold, the Company recognizes the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with the related tax authority. For tax positions not meeting the more likely than not test, no tax benefit is recorded. Any interest and/or penalties related to income taxes are reported as a component of income tax expense.

The Company files a consolidated federal income tax return.

Comprehensive income—Comprehensive income consists of net income and other comprehensive income which includes unrealized gains and losses on securities available for sale which are also recognized as separate components of equity.

Fair Value of Financial Instruments—Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

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Operating Segments—While management monitors the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Company-wide basis. All of the financial service operations are considered by management to be aggregated in one reportable operating segment.

Reclassifications—Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or shareholders' equity.

Earnings per Common Share—Basic earnings per common share is calculated as net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock options, restricted stock awards and the Employee Stock Purchase Plan.

Loss Contingencies—Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there are such matters that will have a material effect on the financial statements.

Dividend Restrictions—Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to Allegiance or by Allegiance to its shareholders. In addition, Allegiance's credit agreement with another financial institution also limits its ability to pay dividends.

Revenue from Contracts with Customers-The Company records revenue from contracts with customers in accordance with Accounting Standards Codification Topic 606, "Revenue from Contracts with Customers" ("Topic 606"). Under Topic 606, the Company must identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the Company satisfies a performance obligation. Significant revenue has not been recognized in the current reporting period that results from performance obligations satisfied in previous periods.

The Company's primary sources of revenue are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of Topic 606. The Company has evaluated the nature of its contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the Consolidated Statements of Income was not necessary. The Company generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed; charged either on a periodic basis or based on activity. Because performance obligations are satisfied as services are rendered and the transaction prices are fixed, the Company has made no significant judgments in applying the revenue guidance prescribed in ASC 606 that affect the determination of the amount and timing of revenue from contracts with customers.

New Accounting Standards

Adoption of New Accounting Standards

ASU 2014-09 "Revenue from Contracts with Customers (Topic 606)." ASU 2014-09 supersedes the revenue recognition requirements in Revenue Recognition (Topic 605), and most industry-specific guidance throughout the Industry Topics of the Codification. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new standard was effective for the Company on January 1, 2018 and management has completed its analysis of the impact of the standard's adoption. Adoption of the ASU did not have a significant impact on the Company's consolidated financial statements and related disclosures. The Company's primary sources of revenue are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of ASU 2014-09. The Company's revenue recognition pattern for revenue streams within the scope of ASU 2014-09, including but not limited to service charges on deposit accounts and gains/losses on the sale of OREO, did not change significantly from current practice. The standard permits the use of either the full retrospective or modified retrospective transition method. The Company elected to use the modified retrospective transition method which requires application of ASU 2014-09 to uncompleted contracts at the date of adoption; however, periods prior to the date of adoption will not be retrospectively revised as the impact of the ASU on uncompleted contracts at the date of adoption was not material.

ASU No. 2016-01, "Financial Instruments - Overall (Subtopic 825-10): Recognition of Financial Assets and Financial Liabilities." ASU 2016-01 makes targeted amendments to fair value measurement and disclosure guidance. ASU 2016-01 requires equity investments (other than equity method investments) to be measured at fair value with changes in fair value recognized in net income. This change is only applied if a readily determinable fair value can be obtained. Adoption of the standard also resulted in the use of an exit price rather than an entrance price to determine the fair value of loans not measured at fair value on a non-recurring basis in the consolidated balance sheets. See Note 7 – Fair Value disclosures for further information regarding the valuation of these loans. ASU 2016-01 became effective for the Company on January 1, 2018.

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ASU 2017-01, “Business Combinations (Topic 805): Clarifying the Definition of a Business,” (“ASU 2017-01”) to improve such definition and, as a result, assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or as business combinations. The definition of a business impacts many areas of accounting including acquisitions, disposals, goodwill and consolidation. ASU 2017-01 became effective for the Company on January 1, 2018 and is to be applied under a prospective approach. The Company expects the adoption of this new guidance to impact the determination of whether future acquisitions are considered business combinations or asset purchases.

Newly Issued But Not Yet Effective Accounting Standards

ASU 2016-02 “Leases (Topic 842)." ASU 2016-02 will, among other things, require lessees to recognize a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. ASU 2016-02 does not significantly change lease accounting requirements applicable to lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model and ASC Topic 606, “Revenue from Contracts with Customers.” The new standard was adopted by the Company on January 1, 2019. ASU 2016-02 provides for a modified retrospective transition approach requiring lessees to recognize and measure leases on the balance sheet at the beginning of either the earliest period presented or as of the beginning of the period of adoption. The Company has elected to apply ASU 2016-02 as of the beginning of the period of adoption (January 1, 2019) and will not restate comparative periods. The Company expects that the adoption of ASU 2016-02 will result in the recognition of lease liabilities totaling $15,000,000 to $17,000,000 and the recognition of right-of-use assets totaling $15,000,000 to $17,000,000, which results in an estimated 5 basis point decrease in the tier 1 capital to risk weighted assets ratio as of the date of adoption. The initial balance sheet gross up upon adoption is primarily related to operating leases of certain real estate properties. The Company has no material leasing arrangements for which it is the lessor of property or equipment. The Company has made an accounting policy election to not apply the recognition requirements in the new standard to short-term leases. The Company has elected to apply the package of practical expedients allowed by the new standard under which the Company need not reassess whether any expired or existing contracts are or contain leases, the Company need not reassess the lease classification for any expired or existing lease, and the Company need not reassess initial direct costs for any existing leases. The Company has also elected to use the practical expedient to make an accounting policy election for leases of certain underlying assets to include both lease and nonlease components as a single component and account for it as a lease. Adoption of ASU 2016-02 is not expected to materially change the Company’s recognition of lease expense in future periods.

ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” Among other things, ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better form 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, ASU 2016-13 amends the accounting for credit losses on available for sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 is effective for the Company on January 1, 2020 and must be applied using the modified retrospective approach with limited exceptions. Early adoption is permitted for fiscal years, and interim periods within those years, beginning after December 15, 2018. While the Company is currently unable to reasonably estimate the impact of adopting ASU 2016-13, the Company expects that the impact of adoption will be significantly influenced by the composition, characteristics and quality of its loan and securities portfolios as well as the prevailing economic conditions and forecasts as of the adoption date.

ASU No. 2017-04, “Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.” ASU 2017-04 eliminates Step 2 from the goodwill impairment test which required entities to compute the implied fair value of goodwill. Under ASU 2017-04, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. ASU 2017-04 will be effective for the Company on January 1, 2020, with earlier adoption permitted and is not expected to have a significant impact on the Company's financial statements.

ASU 2017-08,“Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20) - Premium Amortization on Purchased Callable Debt Securities.” ASU 2017-08 shortens the amortization period for certain callable debt securities held at a premium to require such premiums to be amortized to the earliest call date unless applicable guidance related to certain pools of securities is applied to consider estimated prepayments. Under prior guidance, entities were generally required to amortize premiums on individual, non-pooled callable debt securities as a yield adjustment over the contractual life of the security. ASU 2017-08 does not change the accounting for callable debt securities held at a discount. ASU 2017-08 became effective for the Company on January 1, 2019, with early adoption permitted. The Company will record a $1.7 million impact of ASU 2017-08 in its 2019 financial statements.

ASU 2018-02, “Income Statement - Reporting Comprehensive Income (Topic 220) - Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.” ASU 2018-02 amends ASC 220, Income Statement - Reporting Comprehensive Income, to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from

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the Tax Cuts and Jobs Act. ASU 2018-02 is effective on January 1, 2019, with early adoption permitted. The Company early adopted ASU 2018-02 and recognized a decrease to retained earnings of $72 thousand due to a reclassification on January 1, 2018.

2. ACQUISITIONS

Acquisitions are accounted for using the acquisition method of accounting. Accordingly, the assets and liabilities of an acquired entity are recorded at their fair value at the acquisition date. The excess of the purchase price over the estimated fair value of the net assets is recorded as goodwill. The results of operations for an acquisition have been included in the Company's consolidated financial results beginning on the respective acquisition date.

The measurement period for the Company to determine the fair values of acquired identifiable assets and assumed liabilities will end at the earlier of (1) twelve months from the date of the acquisition or (2) as soon as the Company receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. The following acquisition was completed on the date indicated below:

2018 Acquisition

Acquisition of Post Oak Bancshares, Inc.—On October 1, 2018, the Company completed the acquisition of Post Oak Bancshares, Inc. ("Post Oak") and its wholly-owned subsidiary Post Oak Bank, N.A. headquartered in Houston, Texas. Post Oak operated thirteen bank offices, twelve located throughout the greater Houston metropolitan area and one in Beaumont, just outside of the Houston metropolitan area. The Company acquired Post Oak to further expand its Houston, Texas area market. Goodwill resulted from a combination of expected operational synergies and an enhanced branching network. Goodwill is not expected to be deductible for tax purposes.

Pursuant to the merger agreement, the Company issued 8,402,010 shares of Company common stock for all outstanding shares of Post Oak common stock and paid $21 thousand in cash for any fractional shares held by Post Oak shareholders. Additionally, all outstanding Post Oak options were assumed by Allegiance and converted using the 0.7017 exchange ratio to 299,352 options at a weighted average exercise price of $12.83 per option. Based on the $41.70 per share closing price of Allegiance common stock on September 28, 2018, the total transaction value was approximately $359.0 million. The acquisition was accounted for under the acquisition method of accounting in accordance with ASC Topic 805, Business Combinations. The Company recognized goodwill of $183.7 million which is calculated as the excess of both the consideration exchanged and liabilities assumed as compared to the fair value of identifiable assets acquired, none of which is expected to be deductible for tax purposes. The intangible assets recognized in the transaction will be amortized utilizing an accelerated method over their ten year estimated useful lives. The initial accounting for the acquisition has not been completed because the fair values of the assets acquired and liabilities assumed have not yet been finalized.

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As of October 1, 2018, the Company finalized its valuation of all assets and liabilities acquired, resulting in no changes to preliminary acquisition accounting adjustments. A summary of the final purchase price allocation is as follows (in thousands):

Fair value of consideration paid:	
Common shares issued (8,402,010 shares)	$350,364
Stock options issued (299,352)	8,639
Cash in lieu of fractional shares	21
Total consideration paid	$359,024
Fair value of assets acquired:	
Cash and cash equivalents	$230,416
Investment securities	42,779
Loans	1,164,279
Premises and equipment	21,988
Core deposit intangibles	25,128
Other assets	18,078
Total assets acquired	$1,502,668
Fair value of liabilities assumed:	
Deposits	$1,291,310
Other borrowed funds	30,000
Other liabilities	6,070
Total liabilities assumed	1,327,380
Fair value of net assets acquired	$175,288
Goodwill resulting from acquisition	$183,736

The fair value of net assets acquired includes fair value adjustments to certain acquired loans that were not considered impaired as of the acquisition date. The fair value adjustments were determined using discounted contractual cash flows. The following presents details of all loans acquired as of October 1, 2018:

	Contractual Balance	Fair Value	Discount
	(Dollars in thousands)		
Commercial and industrial	$221,098	$217,204	$(3,894)
Real estate:			
Commercial real estate (including multi-family residential)	450,947	443,512	(7,435)
Commercial real estate	167,386	165,387	(1,999)

construction and land development			
1-4 family residential (including home equity)	288,304	285,099	(3,205)
Residential construction	23,812	23,812	—
Consumer and other	29,684	29,267	(417)
Total loans	$1,181,231	$1,164,281	$(16,950)

In connection with the Post Oak acquisition, the Company acquired loans both with and without evidence of credit quality deterioration since origination. The acquired loans were initially recorded at fair value with no carryover of any allowance for loan losses. Acquired loans were segregated between those considered to be purchased credit impaired ("PCI") loans and those without credit impairment at acquisition.

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PCI Loans.

The following presents information at the acquisition date for PCI loans acquired in the transaction (dollars in thousands):

Contractually required principal and interest payments	$28,340
Contractual cash flows not expected to be collected (nonaccretable difference)	3,163
Expected cash flows at acquisition	25,177
Interest component of expected cash flows (accretable yield)	495
Fair value of loans acquired with deterioration of credit quality	$24,682

Non-PCI Loans.

The following table presents information at the acquisition date for non-PCI loans acquired in the transaction (in thousands):

Contractually required principal and interest payments	$1,153,317
Accretable discount	13,293
Fair value at acquisition	$1,140,024

The following table presents unaudited pro forma financial information as if the acquisition had occurred at the beginning of 2017. Post Oak's results of operations were included in the Company's results beginning October 1, 2018. The pro forma financial information is not necessarily indicative of the results of operations that would have occurred had the transaction been effected on the assumed dates.

	For the Years Ended December 31,	
	2018	2017
	(Dollars in thousands, except per share data)	
Net interest income	$ 170,801	$ 165,612
Noninterest income	10,060	9,543
Net income	41,807	35,107
Basic earnings per common share	2.70	1.63

Diluted earnings per common share	2.65	1.61

To determine pro forma information, the Company adjusted its year ended December 31, 2018 and 2017 historical results to include the historical results for Post Oak for the year ended December 31, 2017 and the nine months ended September 30, 2018.

The pro forma information includes acquisition accounting adjustments to interest on loans, certificates of deposit and subordinated debt, difference in the rate of borrowed funds, amortization of intangibles arising from the transaction and the related income tax effects.

Earnings of Post Oak since the acquisition date have not been disclosed as the acquired company was merged into the Company and separate financial information is not readily available.

The Company incurred approximately $1.7 million of pre-tax acquisition and merger-related expenses during the year ended December 31, 2018 related to the Post Oak acquisition. The acquisition and merger-related expenses are reflected on the Company’s income statement for 2018 but are excluded from the calculation of pro forma income above.

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3. GOODWILL AND CORE DEPOSIT INTANGIBLES

Changes in the carrying amount of the Company's goodwill and core deposit intangibles were as follows:

	Goodwill	Core Deposit Intangible Assets
	(Dollars in thousands)	
Balance as of January 1, 2016	$39,389	$ 5,230
Sale of branch assets	—	(390)
Amortization	—	(785)
Balance as of December 31, 2016	39,389	4,055
Amortization	—	(781)
Balance as of December 31, 2017	39,389	3,274
Acquisition of Post Oak Bancshares, Inc.	183,736	25,128
Amortization	—	(1,815)
Balance as of December 31, 2018	$223,125	$ 26,587

Goodwill is recorded on the acquisition date of an entity. During the measurement period, the Company may record subsequent adjustments to goodwill for provisional amounts recorded at the acquisition date. The Company performed its annual impairment test on October 1, 2018 and determined no impairment was necessary.

The estimated aggregate future amortization expense for core deposit intangibles remaining as of December 31, 2018 is as follows (dollars in thousands):

2019	$4,712
2020	3,922
2021	3,296
2022	3,003
2023	2,323
Thereafter	9,331
Total	$26,587

4. CASH AND DUE FROM BANKS

The Bank can be required by the Federal Reserve Bank of Dallas to maintain average reserve balances. “Cash and due from banks” in the consolidated balance sheets included a restricted amount of $27.7 million at December 31, 2018. The Bank was not required to maintain reserve balances at December 31, 2017 or 2016.

5. SECURITIES

The amortized cost and fair value of investment securities were as follows:

	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
U.S. Government and agency securities	$8,570	$ 161	$ (46)	$8,685
Municipal securities	219,068	1,258	(3,541)	216,785
Agency mortgage-backed pass-through securities	66,987	237	(1,029)	66,195
Corporate bonds and other	46,303	15	(690)	45,628
Total	$340,928	$ 1,671	$ (5,306)	$337,293

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ALLEGIANCE BANCSHARES, INC.

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	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
U.S. Government and agency securities	$8,507	$ 232	$ (24)	$8,715
Municipal securities	222,330	2,470	(1,842)	222,958
Agency mortgage-backed pass-through securities	32,014	159	(361)	31,812
Corporate bonds and other	46,247	62	(179)	46,130
Total	$309,098	$ 2,923	$ (2,406)	$309,615

As of December 31, 2018, the Company's management did not expect to sell any securities classified as available for sale with material unrealized losses; and the Company believes that it is more likely than not it will not be required to sell any of these securities before their anticipated recovery at which time the Company will receive full value for the securities. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of December 31, 2018, management believes the unrealized losses in the previous table are temporary and no other than temporary impairment loss has been realized in the Company’s consolidated statements of income.

The amortized cost and fair value of investment securities at December 31, 2018, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations at any time with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(Dollars in thousands)	
Due in one year or less	$14,877	$14,823
Due after one year through five years	73,675	72,790
Due after five years through ten years	87,391	86,880
Due after ten years	97,998	96,605
Subtotal	273,941	271,098
Agency mortgage-backed pass through securities	66,987	66,195
Total	$340,928	$337,293

Securities with unrealized losses segregated by length of time such securities have been in a continuous loss position are as follows:

	December 31, 2018					
	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
	(Dollars in thousands)					
Available for Sale						
U.S. Government and agency securities	$999	$ —	$1,417	$ (46)	$2,416	$ (46)
Municipal securities	10,140	(29)	136,934	(3,512)	147,074	(3,541)
Agency mortgage-backed pass-through securities	17,168	(209)	22,819	(820)	39,987	(1,029)
Corporate bonds and other	13,634	(35)	29,014	(655)	42,648	(690)
Total	$41,941	$ (273)	$190,184	$ (5,033)	$232,125	$ (5,306)

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	December 31, 2017					
	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
	(Dollars in thousands)					
Available for Sale						
U.S. Government and agency securities	$3,110	$ (9)	$595	$ (15)	$3,705	$ (24)
Municipal securities	42,249	(517)	56,483	(1,325)	98,732	(1,842)
Agency mortgage-backed pass-through securities	13,238	(105)	8,921	(256)	22,159	(361)
Corporate bonds and other	30,203	(179)	—	—	30,203	(179)
Total	$88,800	$ (810)	$65,999	$ (1,596)	$154,799	$ (2,406)

There were no realized losses on the securities in the portfolio as the Company believes these securities are temporarily impaired due to changes in market interest rates. The majority of the securities in an unrealized loss position are related to the Company's municipal securities.

During 2018, the Company acquired $42.8 million and sold $12.7 million of securities acquired in the Post Oak transaction. No gains or losses were recognized. During 2017, the Company sold $39.1 million in securities and recorded a net gain on the sales of $18 thousand. The Company sold $2.5 million in securities during 2016 and recorded a gain on the sale of $30 thousand.

At December 31, 2018 and 2017, the Company did not own securities of any one issuer, other than the U.S. government and its agencies, in an amount greater than 10% of the consolidated shareholders' equity at such respective dates.

The carrying value of pledged securities $28.9 million and $5.0 million at December 31, 2018 and 2017, respectively. The increase in pledged securities during the year ended December 31, 2018 was primarily due to $25.9 million of pledged securities that were acquired from Post Oak. The majority of the securities were pledged to collateralize public fund deposits.

6. LOANS AND ALLOWANCE FOR LOAN LOSSES

The loan portfolio balances, net of unearned income and fees, consist of various types of loans primarily all made to borrowers located within Texas and are classified by major type as follows:

	December 31, 2018	2017
	(Dollars in thousands)	
Commercial and industrial	$702,037	$457,129
Mortgage warehouse	48,274	69,456
Real estate:		
Commercial real estate (including multi-family residential)	1,650,912	1,080,247
Commercial real estate construction and land development	430,128	243,389
1-4 family residential (including home equity)	649,311	301,219
Residential construction	186,411	109,116
Consumer and other	41,233	10,320
Total loans	3,708,306	2,270,876
Allowance for loan losses	(26,331)	(23,649)
Loans, net	$3,681,975	$2,247,227

(1) Mortgage warehouse loans are to unaffiliated mortgage loan originators collateralized by mortgage promissory notes which are segregated in the Company's mortgage warehouse portfolio. These promissory notes originated by the Company's mortgage warehouse customers carry terms and conditions as would be expected in the competitive permanent mortgage market and serve as collateral under a traditional mortgage warehouse arrangement whereby such promissory notes are warehoused under a revolving credit facility to allow for the end investor (or purchaser) of the note to receive a complete loan package and remit funds to the bank. The maturity of each revolving line of credit facility is normally less than 24 months, while the promissory

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notes that are warehoused under such facilities may have a much shorter length of time outstanding. For mortgage promissory notes secured by residential property, the warehouse time is normally 10 to 20 days. For mortgage promissory notes secured by commercial property, the warehouse time is normally 40 to 50 days. The funded balance of the mortgage warehouse portfolio can have significant fluctuation based upon market demand for the product, level of home sales and refinancing activity, market interest rates and velocity of end investor processing times.

Loan Origination/Risk Management

The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. The Company maintains an independent loan review department that reviews and validates the credit risk program on a periodic basis. In addition, an independent third party loan review is performed on a semi-annual basis.

(i) Commercial and Industrial Loans. The Company makes commercial and industrial loans in its market area that are underwritten on the basis of the borrower’s ability to service the debt from income. The Company generally takes as collateral a lien on any available real estate, equipment or other assets owned by the borrower and typically obtains a personal guaranty of the borrower or principal. In general, commercial loans involve more credit risk than residential mortgage loans and commercial mortgage loans and therefore typically yield a higher return. The increased risk in commercial loans derives from the expectation that commercial and industrial loans generally are serviced principally from the operations of the business, which may not be successful and from the type of collateral securing these loans. As a result, commercial and industrial loans require more extensive underwriting and servicing than other types of loans.

(ii) Commercial Real Estate. The Company makes loans collateralized by owner-occupied, nonowner-occupied and multi-family real estate to finance the purchase or ownership of real estate.

The Company’s nonowner-occupied and multi-family commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is dependent, in large part, on sufficient income from the properties securing the loans to cover operating expenses and debt service. The Company generally requires the borrower to have had an existing relationship with the Company and have a proven record of success. In addition, these loans are generally guaranteed by individual owners of the borrower and have typically lower loan to value ratios.

Loans secured by owner-occupied properties generally involve less risk and represented 51.4% of the outstanding principal balance of the Company’s commercial real estate loans at December 31, 2018. The Company is dependent on the cash flows of the business occupying the property and its owners and requires these loans to be secured by property with adequate margins and to be guaranteed by the individual owners. The Company’s owner-occupied commercial real estate loans collateralized by first liens on real estate typically have fixed interest rates and amortize over a 10 to 20 year period.

(iii) Construction and Land Development Loans. The Company makes loans to finance the construction of residential and to a lesser extent nonresidential properties. Construction loans generally are collateralized by first liens on real estate and have floating interest rates. The Company generally conducts periodic inspections, either directly or through an agent, prior to approval of periodic draws on these loans. Underwriting guidelines similar to those described above are also used in the Company’s construction lending activities. Construction loans involve additional risks as they often involve the disbursement of funds with the repayment dependent on the ultimate success of the project’s completion. Sources of repayment for these loans may be pre-committed permanent financing or sale of the developed property. The loans in this portfolio are monitored closely by management. Due to uncertainties inherent in estimating construction costs, the market value of the completed project and the effects of governmental regulation on real property, it can be difficult to accurately evaluate the total funds required to complete a project and the related loan to value ratio. As a result of these uncertainties, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. If the Company is forced to foreclose on a project prior to completion, there is no assurance that the Company will be able to recover all of the unpaid portion of the loan. In addition, the Company may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate period of time.

(iv) Residential Real Estate Loans. The Company’s lending activities also include the origination of 1-4 family residential mortgage loans (including home equity loans) collateralized by owner-occupied residential properties located in the Company’s market areas. The Company offers a variety of mortgage loan portfolio products which have a term of 5 to 7 years and generally amortize over 10 to 20 years. Loans collateralized by 1-4 family residential real estate generally have been originated in amounts of no more than 90% of appraised value.

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(v) Consumer and Other Loans. The Company makes a variety of loans to individuals for personal and household purposes including secured and unsecured installment and term loans. Consumer loans are underwritten based on the individual borrower’s income, current debt level, past credit history and the value of any available collateral. The terms of these loans typically range from 12 to 60 months and vary based upon the nature of collateral and size of loan. Generally, consumer loans entail greater risk than residential real estate loans because they may be unsecured or if secured the value of the collateral, such as an automobile or boat, may be more difficult to assess and more likely to decrease in value than real estate. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan balance. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower’s continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws may limit the amount which can be recovered on such loans.

Acquired Loans

PCI loans

The carrying amount of PCI loans included in the consolidated balance sheet and the related outstanding balance owed at December 31, 2018 are presented in the table below (in thousands):

PCI loans:	
Outstanding balance at December 31, 2018	$26,862
Less: Discount	3,599
Recorded investment at December 31, 2018	$23,263

Changes in the accretable yield for PCI loans for the year ended December 31, 2018 were as follows (in thousands):

Balance at beginning of period	$—
Additions	495
Reclassifications from nonaccretable	—
Accretion	59
Balance at December 31, 2018	$436

Non-PCI Loans.

The carrying amount of Non-PCI loans included in the consolidated balance sheet and the related outstanding balance owed at December 31, 2018 are presented in the table below (in thousands).

Non-PCI loans:	
Outstanding balance at December 31, 2018	$1,124,342
Less: Discount	10,650
Recorded investment at December 31, 2018	$1,113,692

Changes in the discount accretion for Non-PCI loans for the years ended December 31, 2018 were as follows (in thousands):

Balance at beginning of period	$—
Additions	13,293
Reclassifications from nonaccretable	—
Accretion	2,643
Balance at December 31, 2018	$10,650

Concentrations of Credit

The vast majority of the Company's lending activity occurs in and around the Houston, Texas area. The Company's loans are primarily loans secured by real estate, including commercial and residential construction, owner-occupied and nonowner-occupied and multi-family commercial real estate, raw land and other real estate based loans.

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Related Party Loans

As of December 31, 2018 and 2017, loans outstanding to directors, officers and their affiliates totaled $7.9 million and $4.4 million, respectively.

An analysis of activity with respect to these related-party loans is as follows:

	2018 (Dollars in thousands)
Beginning balance on January 1	$ 4,368
New loans and reclassified related loans	5,003
Repayments	(1,501)
Ending balance on December 31	$ 7,870

Nonaccrual and Past Due Loans

An aging analysis of the recorded investment in past due loans, segregated by class of loans, is as follows:

	December 31, 2018					
	Loans Past Due and Still Accruing					
	30-89 Days	90 or More Days	Total Past Due Loans	Nonaccrual Loans	Current Loans	Total Loans
	(Dollars in thousands)					
Commercial and industrial	$ 1,951	$ —	$ 1,951	$ 10,861	$ 689,225	$ 702,037
Mortgage warehouse	—	—	—	—	48,274	48,274
Real estate:						
Commercial real estate (including multi-family residential)	3,502	—	3,502	17,776	1,629,634	1,650,912
Commercial real estate construction and land development	1,300	—	1,300	974	427,854	430,128
1-4 family residential	3,643	—	3,643	3,201	642,467	649,311

(including home equity)						
Residential construction	-	—	-	—	186,411	186,411
Consumer and other	91	—	91	141	41,001	41,233
Total loans	$10,487	$ —	$ 10,487	$ 32,953	$3,664,866	$3,708,306

	December 31, 2017					
	Loans Past Due and Still Accruing					
	30-89 Days	90 or More Days	Total Past Due Loans	Nonaccrual Loans	Current Loans	Total Loans
	(Dollars in thousands)					
Commercial and industrial	$1,069	$ —	$ 1,069	$ 6,437	$449,623	$457,129
Mortgage warehouse	—	—	—	—	69,456	69,456
Real estate:						
Commercial real estate (including multi-family residential)	4,932	—	4,932	6,110	1,069,205	1,080,247
Commercial real estate construction and land development	5,274	—	5,274	—	238,115	243,389
1-4 family residential (including home equity)	924	—	924	781	299,514	301,219
Residential construction	674	—	674	—	108,442	109,116
Consumer and other	74	—	74	—	10,246	10,320
Total loans	$12,947	$ —	$ 12,947	$ 13,328	$2,244,601	$2,270,876

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If interest on nonaccrual loans had been accrued under the original loan terms, approximately $1.0 million and $733 thousand would have been recorded as income for the years ended December 31, 2018 and 2017, respectively.

Impaired Loans

Impaired loans by class of loans are set forth in the following tables.

	December 31, 2018		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in thousands)		
With no related allowance recorded:			
Commercial and industrial	$4,354	$4,771	$ —
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	11,322	11,322	—
Commercial real estate construction and land development	1,326	1,326	—
1-4 family residential (including home equity)	2,742	2,741	—
Residential construction	—	—	—
Consumer and other	3	3	—
Total	19,747	20,163	—
With an allowance recorded:			
Commercial and industrial	9,150	9,545	3,898
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	11,542	11,542	2,641
Commercial real estate construction and land development	3,114	3,114	190
1-4 family residential (including home equity)	—	—	—

Residential construction	—	—	—
Consumer and other	—	—	—
Total	23,806	24,201	6,729
Total:			
Commercial and industrial	13,504	14,316	3,898
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	22,864	22,864	2,641
Commercial real estate construction and land development	4,440	4,440	190
1-4 family residential (including home equity)	2,742	2,741	—
Residential construction	—	—	—
Consumer and other	3	3	—
	$43,553	$44,364	$ 6,729

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	December 31, 2017		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in thousands)		
With no related allowance recorded:			
Commercial and industrial	$5,792	$6,666	$ —
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	12,155	12,155	—
Commercial real estate construction and land development	209	209	—
1-4 family residential (including home equity)	948	948	—
Residential construction	—	—	—
Consumer and other	—	—	—
Total	19,104	19,978	—
With an allowance recorded:			
Commercial and industrial	5,600	5,652	1,640
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	8,009	8,194	716
Commercial real estate construction and land development	—	—	—
1-4 family residential (including home equity)	—	—	—
Residential construction	—	—	—
Consumer and other	—	—	—
Total	13,609	13,846	2,356
Total:			
Commercial and industrial	11,392	12,318	1,640
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including	20,164	20,349	716

multi-family residential)			
Commercial real estate construction and land development	209	209	—
1-4 family residential (including home equity)	948	948	—
Residential construction	—	—	—
Consumer and other	—	—	—
	$32,713	$33,824	$ 2,356

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The following table presents the average recorded investment of impaired loans and interest recognized on impaired loans.

	Years Ended December 31,			
	2018		2017	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
Commercial and industrial	$14,555	$ 423	$11,972	$ 418
Mortgage warehouse	—	—	—	—
Real estate:				
Commercial real estate (including multi-family residential)	23,198	756	20,606	475
Commercial real estate construction and land development	4,247	98	314	10
1-4 family residential (including home equity)	2,815	—	1,167	18
Residential construction	—	—	—	—
Consumer and other	3	5	-	1
Total	$44,818	$ 1,282	$34,059	$ 922

The average recorded investment of impaired loans for the year ended December 31, 2016 was $22.5 million. Interest income recognized for the year ended December 31, 2016 was $862 thousand.

Credit Quality Indicators

The company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt including factors such as: current financial information, historical payment experience, credit documentation, public information and current economic trends. The Company analyzes loans individually by classifying the loans by credit risk. As part of the ongoing monitoring of the credit quality of the Company’s loan portfolio and methodology for calculating the allowance for credit losses, management assigns and tracks risk ratings to be used as credit quality indicators.

The following is a general description of the risk ratings used:

Watch—Loans classified as watch loans may still be of high quality, but have an element of risk added to the credit such as declining payment history, deteriorating financial position of the borrower or a decrease in collateral value.

Special Mention—Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Substandard—Loans classified as substandard have well-defined weaknesses on a continuing basis and are inadequately protected by the current net worth and paying capacity of the borrower, impaired or declining collateral values, or a continuing downturn in their industry which is reducing their profits to below zero and having a significantly negative impact on their cash flow. These loans so classified are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful—Loans classified as doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans.

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Based on the most recent analysis performed, the risk category of loans by class of loan at December 31, 2018 is as follows:

	Pass	Watch	Special Mention	Substandard	Doubtful	Total
	(Dollars in thousands)					
Commercial and industrial	$656,783	$9,696	$13,874	$ 21,684	$ —	$702,037
Mortgage warehouse	48,274	—	—	—	—	48,274
Real estate:						
Commercial real estate (including multi-family residential)	1,570,243	29,702	7,101	43,866	—	1,650,912
Commercial real estate construction and land development	424,460	729	2,149	2,790	—	430,128
1-4 family residential (including home equity)	629,657	3,797	4,216	11,641	—	649,311
Residential construction	186,411	—	—	—	—	186,411
Consumer and other	40,673	31	301	228	—	41,233
Total loans	$3,556,501	$43,955	$27,641	$ 80,209	$ —	$3,708,306

The following table presents the risk category of loans by class of loan at December 31, 2017:

	Pass	Watch	Special Mention	Substandard	Doubtful	Total
	(Dollars in thousands)					
Commercial and industrial	$427,336	$10,274	$ 2,195	$ 17,324	$ —	$457,129
Mortgage warehouse	69,456	—	—	—	—	69,456
Real estate:						
Commercial real estate	1,016,831	23,039	4,685	35,692	—	1,080,247
(including multi-family						

residential)						
Commercial real estate construction and land development	231,536	4,397	—	7,456	—	243,389
1-4 family residential (including home equity)	295,744	2,696	785	1,994	—	301,219
Residential construction	103,611	5,505	—	—	—	109,116
Consumer and other	10,207	111	—	2	—	10,320
Total loans	$2,154,721	$46,022	$7,665	$62,468	$—	$2,270,876

Allowance for Loan Losses

At December 31, 2018, the allowance for loan losses totaled $26.3 million, or 0.71% of total loans. At December 31, 2017, the allowance totaled $23.6 million or 1.04% of total loans. Acquired loans are carried over without an allowance for loan losses as they are recorded at fair value at the acquisition date. However, the Company recorded a discount on the acquired loans which will be prospectively accreted, increasing its basis in such loans. At December 31, 2018, the balance of the acquisition accounting discount was $14.2 million.

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The following table presents the activity in the allowance for loan losses by portfolio type for the years ended December 31, 2018, 2017 and 2016:

	Commercial and industrial	Mortgage warehouse	Commercial real estate (including multi-family residential)	Commercial real estate construction and land development	1-4 family residential (including home equity)	Residential construction	Consumer and other	Total
	(Dollars in thousands)							
Allowance for loan losses:								
Balance December 31, 2017	$7,694	$ —	$ 10,253	$ 2,525	$ 2,140	$ 942	$ 95	$23,649
Provision for loan losses	2,234	—	1,588	199	127	98	2	4,248
Charge-offs	(2,424)	—	(42)	—	(25)	—	(24)	(2,515)
Recoveries	847	—	102	—	—	—	—	949
Net charge-offs	(1,577)	—	60	—	(25)	—	(24)	(1,566)
Balance December 31, 2018	$8,351	$ —	$ 11,901	$ 2,724	$ 2,242	$ 1,040	$ 73	$26,331
Allowance for loan losses:								
Balance December 31, 2016	$5,059	$ —	$ 8,950	$ 1,217	$ 1,876	$ 748	$ 61	$17,911
Provision for loan losses	9,792	—	1,424	1,298	254	194	226	13,188
Charge-offs	(7,673)	—	(124)	—	—	—	(196)	(7,993)
Recoveries	516	—	3	10	10	—	4	543
Net charge-offs	(7,157)	—	(121)	10	10	—	(192)	(7,450)
Balance December 31, 2017	$7,694	$ —	$ 10,253	$ 2,525	$ 2,140	$ 942	$ 95	$23,649
Allowance for loan losses:								
Balance December 31, 2015	$3,644	$ —	$ 5,914	$ 1,221	$ 1,432	$ 820	$ 67	$13,098
Provision for loan losses	1,951	—	3,122	(4)	434	(72)	38	5,469
Charge-offs	(722)	—	(129)	—	—	—	(49)	(900)
Recoveries	186	—	43	—	10	—	5	244
Net charge-offs	(536)	—	(86)	—	10	—	(44)	(656)
	$5,059	$ —	$ 8,950	$ 1,217	$ 1,876	$ 748	$ 61	$17,911

Balance December 31, 2016	

The following table presents the balance in the allowance for loan losses by portfolio type based on the impairment method as of December 31, 2018 and 2017:

	Commercial and industrial	Mortgage warehouse	Commercial real estate (including multi-family residential)	Commercial real estate construction and land development	1-4 family residential (including home equity)	Residential construction	Consumer and other	Total
	(Dollars in thousands)							
Allowance for loan losses related to:								
December 31, 2018								
Individually evaluated for impairment	$3,898	$ —	$ 2,641	$ 190	$ —	$ —	$ —	$6,729
Collectively evaluated for impairment	4,453	—	9,260	2,534	2,242	1,040	73	19,602
Total allowance for loan losses	$8,351	$ —	$ 11,901	$ 2,724	$ 2,242	$ 1,040	$ 73	$26,331
Allowance for loan losses related to:								
December 31, 2017								
Individually evaluated for impairment	$1,640	$ —	$ 716	$ —	$ —	$ —	$ —	$2,356
Collectively evaluated for impairment	6,054	—	9,537	2,525	2,140	942	95	21,293
Total allowance for loan	$7,694	$ —	$ 10,253	$ 2,525	$ 2,140	$ 942	$ 95	$23,649

losses

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The following table presents the recorded investment in loans held for investment by portfolio type based on the impairment method as of December 31, 2018 and 2017:

	Commercial and industrial	Mortgage warehouse	Commercial real estate (including multi-family residential)	Commercial real estate construction and land development	1-4 family residential (including home equity)	Residential construction	Consumer and other	Total
	(Dollars in thousands)							
Recorded investment in loans:								
December 31, 2018								
Individually evaluated for impairment	$13,504	$—	$22,864	$4,440	$2,742	$—	$3	$43,553
Collectively evaluated for impairment	688,533	48,274	1,628,048	425,688	646,569	186,411	41,230	3,664,753
Total loans evaluated for impairment	$702,037	$48,274	1,650,912	$430,128	$649,311	$186,411	$41,233	$3,708,306
Recorded investment in loans:								
December 31, 2017								
Individually evaluated for impairment	$11,392	$—	$20,164	$209	$948	$—	$—	$32,713
Collectively evaluated for impairment	445,737	69,456	1,060,083	243,180	300,271	109,116	10,320	2,238,163
Total loans evaluated for	$457,129	$69,456	$1,080,247	$243,389	$301,219	$109,116	$10,320	$2,270,876

impairment

Troubled Debt Restructurings

As of December 31, 2018 and 2017, the Company had a recorded investment in troubled debt restructurings of $33.1 million and $25.6 million, respectively. The Company allocated $3.0 million and $2.2 million of specific reserves for these loans at December 31, 2018 and 2017, respectively, and did not commit to lend additional amounts on these loans.

The following table presents information regarding loans modified in a troubled debt restructuring during the years ended December 31, 2018, 2017 and 2016:

	As of December 31, 2018			2017			2016		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification of Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification of Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification of Outstanding Recorded Investment
	(Dollars in thousands)								
Troubled Debt Restructurings									
Commercial and industrial	11	$ 2,770	$ 2,770	9	$ 2,399	$ 2,399	21	$ 3,939	$ 3,939
Mortgage warehouse	—	—	—	—	—	—	—	—	—
Real estate:									
Commercial real estate (including multi-family residential)	3	4,288	4,288	6	11,837	11,837	8	7,144	7,144
Commercial real estate construction and land development	1	3,114	3,114	1	210	210	—	—	—
1-4 family residential (including home equity)	—	—	—	1	86	86	—	—	—
Residential construction	—	—	—	—	—	—	—	—	—
Consumer and other	—	—	—	—	—	—	1	6	6
Total	15	$ 10,172	$ 10,172	17	$ 14,532	$ 14,532	30	$ 11,089	$ 11,089

Troubled debt restructurings resulted in charge-offs of $272 thousand, $136 thousand and $211 thousand during the years ended December 31, 2018, 2017 and 2016, respectively.

As of December 31, 2018, there were four defaults totaling $200 thousand on loans that were modified as troubled debt restructurings during the preceding 12 months. Default is determined at 90 or more days past due. The modifications primarily related to extending the amortization periods of the loans. The Company did not grant principal reductions on any restructured loans. There were no commitments to lend additional amounts for the years

2018 and 2017. During the year ended December 31, 2018, the Company added $10.2 million in new troubled debt restructurings, of which $9.8 million was still outstanding on December 31, 2018.

ALLEGIANCE BANCSHARES, INC.

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7. FAIR VALUE

The Company uses fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Fair value represents the estimated exchange price that would be received from selling an asset or paid to transfer a liability, otherwise known as an "exit price" in the principal or most advantageous market available to the entity in an orderly transaction between market participants on the measurement date.

Fair Value Hierarchy

- Level 1—Quoted prices for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- Level 2—Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3—Significant unobservable inputs that reflect management's judgment and assumptions that market participants would use in pricing an asset or liability that are supported by little or no market activity.

The carrying amounts and estimated fair values of financial instruments that are reported on the balance sheet are as follows:

	As of December 31, 2018				
	Carrying	Estimated Fair Value			
	Amount	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)				
Financial assets					
Cash and cash equivalents	$268,947	$268,947	$—	$—	$268,947
Available for sale securities	337,293	—	337,293	—	337,293
Loans held for investment, net of allowance	3,681,975	—	—	3,674,241	3,674,241
FHLB stock	10,941	N/A	N/A	N/A	N/A
Accrued interest receivable	17,010	65	3,498	13,447	17,010
Financial liabilities					
Deposits	$3,662,536	$—	$3,653,244	$—	$3,653,244
Accrued interest payable	2,812	—	2,812	—	2,812
Borrowed funds	225,493	—	230,445	—	230,445
Subordinated debt	48,899	—	49,663	—	49,663

	As of December 31, 2017				
	Carrying	Estimated Fair Value			
	Amount	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)				
Financial assets					

Cash and cash equivalents	$182,103	$182,103	$—	$—	$182,103
Available for sale securities	309,615	—	309,615	—	309,615
Loans held for investment, net of allowance	2,247,227	—	—	2,238,721	2,238,721
FHLB stock	12,862	N/A	N/A	N/A	N/A
Accrued interest receivable	12,194	3	3,296	8,895	12,194
Financial liabilities					
Deposits	$2,213,974	$—	$2,209,111	$—	$2,209,111
Accrued interest payable	610	—	610	—	610
Borrowed funds	282,569	—	288,887	—	288,887
Subordinated debt	48,659	—	48,659	—	48,659

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The fair value estimates presented herein are based on pertinent information available to management as of the dates indicated. The following is a description of valuation methodologies used for assets and liabilities recorded at fair value, non-financial assets and non-financial liabilities and for estimating fair value for financial instruments not recorded at fair value:

Cash and Cash Equivalents—For these short-term instruments, the carrying amount is a reasonable estimate of fair value. The Company classifies the estimated fair value of these instruments as Level 1.

Available for Sale Securities—Fair values for investment securities are based upon quoted market prices, if available, and are considered Level 1 inputs. For all other available for sale securities, if quoted prices are not available, fair values are measured based on market prices for similar securities and are considered Level 2 inputs. For these securities, the Company generally obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond’s terms and conditions, among other things.

Available for sale securities are recorded at fair value on a recurring basis.

Loans Held for Investment—The estimated fair value approximates carrying value for variable-rate loans that reprice frequently and that have no significant change in credit risk resulting in a Level 3 classification. Fair values for fixed-rate loans and variable rate loans which reprice infrequently are estimated by discounting future cash flows. In accordance with ASU 2016-01, which was adopted effective January 1, 2018, the discount rates used to determine the fair value of loans at December 31, 2018 used interest rate spreads that reflect factors such as liquidity, credit and nonperformance risk of the loans. The discount rates used to determine the fair value of loans at December 31, 2017 were based on interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification.

Federal Home Loan Bank Stock—The fair value of FHLB stock is estimated to be equal to its carrying amount as it is not practical to determine the fair value of FHLB stock due to restrictions placed on its transferability.

Deposits—The fair value of demand deposits (e.g., interest and noninterest checking, savings and certain types of money market deposits) is the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in a Level 2 classification. The fair value of fixed rate certificates of deposit is estimated using a discounted cash flows calculation that applies interest rates currently offered on certificates of deposit to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

Accrued Interest—The carrying amounts of accrued interest approximate their fair values resulting in a Level 2 or 3 classification.

Borrowed Funds—The fair value of the Company’s borrowed funds are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements and are measured utilizing Level 2 inputs.

Subordinated Debt—The fair values of subordinated debentures and notes are estimated using discounted cash flow analyses based on the Company’s current borrowing rates for similar types of borrowing arrangements and are measured utilizing Level 2 inputs.

Off-balance sheet instruments—The fair values of off-balance sheet commitments to extend credit and standby letters of credit financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The Company has reviewed the unfunded portion of commitments to extend credit as well as standby and other letters of credit and has determined that the fair value of such financial instruments is not material.

ALLEGIANCE BANCSHARES, INC.

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The following tables present fair values for assets measured at fair value on a recurring basis:

	As of December 31, 2018			
	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)			
Available for sale securities:				
U.S. Government and agency securities	$—	$8,685	$ —	$8,685
Municipal securities	—	216,785	—	216,785
Agency mortgage-backed pass-through securities	—	66,195	—	66,195
Corporate bonds and other	—	45,628	—	45,628
Total	$—	$337,293	$ —	$337,293

	As of December 31, 2017			
	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)			
Available for sale securities:				
U.S. Government and agency securities	$—	$8,715	$ —	$8,715
Municipal securities	—	222,958	—	222,958
Agency mortgage-backed pass-through securities	—	31,812	—	31,812
Corporate bonds and other	—	46,130	—	46,130
Total	$—	$309,615	$ —	$309,615

There were no liabilities measured at fair value on a recurring basis as of December 31, 2018 or 2017. There were no transfers between levels during 2018 or 2017.

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is the instruments are not measured at fair value on an ongoing basis, but are subject to fair value adjustments in certain circumstances such as evidence of impairment.

	As of December 31, 2018		
	Level 1	Level 2	Level 3
	(Dollars in thousands)		
Impaired loans:			

Commercial and industrial	$—	$ —	$5,647
Commercial real estate (including multi-family residential)	—	—	8,901
Commercial real estate construction and land development	—	—	2,924
Other real estate owned	—	—	630
	$—	$ —	$18,102

	As of December 31, 2017		
	Level 1	Level 2	Level 3
	(Dollars in thousands)		
Impaired loans:			
Commercial and industrial	$—	$ —	$4,012
Commercial real estate (including multi-family residential)	—	—	7,478
Other real estate owned	—	—	365
	$—	$ —	$11,855

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Historically, the Company measures fair value for certain loans and other real estate owned on a nonrecurring basis as described below.

Impaired Loans with Specific Allocation of Allowance

Impaired loans are those loans the Company has measured at fair value, generally based on the fair value of the loan’s collateral. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due pursuant to the contractual terms of the loan agreement. Impairment is measured by estimating the fair value of the loan based on the present value of expected cash flows, the market price of the loan, or the underlying fair value of the loan’s collateral. For real estate loans, fair value of the impaired loan’s collateral is determined by third party appraisals, which are then adjusted for the estimated selling and closing costs related to liquidation of the collateral. For this asset class, the actual valuation methods (income, sales comparable or cost) vary based on the status of the project or property. For example, land is generally based on the sales comparable method while construction is based on the income and/or sales comparable methods. The unobservable inputs may vary depending on the individual assets with no one of the three methods being the predominant approach. The Company reviews the third party appraisal for appropriateness and adjusts the value downward to consider selling and closing costs, which typically range from 5% to 10% of the appraised value. For non-real estate loans, fair value of the impaired loan’s collateral may be determined using an appraisal, net book value per the borrower’s financial statements or aging reports, adjusted or discounted based on management’s historical knowledge, changes in market conditions from the time of the valuation and management’s expertise and knowledge of the customer and the customer's business.

During the years ended December 31, 2018 and 2017, certain impaired loans were reevaluated and reported at fair value through a specific allocation of the allowance for loan losses. At December 31, 2018, the total reported fair value of impaired loans of $17.5 million based on collateral valuations utilizing Level 3 valuation inputs had a carrying value of $24.2 million that was reduced by specific allowance allocations totaling $6.7 million. At December 31, 2017, the total reported fair value of impaired loans of $11.5 million based on collateral valuations utilizing Level 3 valuation inputs had a carrying value of $13.8 million that was reduced by specific allowance allocations totaling $2.4 million.

Other Real Estate Owned

Other real estate owned is comprised of real estate acquired in partial or full satisfaction of loans. Other real estate owned is recorded at its estimated fair value less estimated selling and closing costs at the date of transfer. Any excess of the related loan balance over the fair value less expected selling costs is charged to the allowance. Subsequent declines in fair value are reported as adjustments to the carrying amount and are recorded against earnings. The fair value of other real estate owned is determined using appraisals or other indications of value based on recent comparable sales of similar properties or assumptions generally observable in the marketplace. For this asset class, the actual valuation methods (income, sales comparable or cost) vary based on the status of the project or property. For example, land is generally based on the sales comparable method while construction is based on the income and/or sales comparable methods. The unobservable inputs may vary depending on the individual assets with no one of the three methods being the predominant approach. The Company reviews the third party appraisal for appropriateness and adjusts the value downward to consider selling and closing costs, which typically range from 5% to 10% of the appraised value.

At December 31, 2018, the balance of other real estate owned consisted of a $630 thousand foreclosed commercial real estate property recorded as a result of obtaining physical possession of the property. The Company had $365 thousand of other real estate owned at December 31, 2017.

8. PREMISES AND EQUIPMENT

Premises and equipment are summarized as follows:

	As of December 31,	
	2018	2017
	(Dollars in thousands)	
Land	$11,586	$5,376
Buildings	23,455	7,977
Leasehold improvements	5,291	5,059
Furniture, fixtures and equipment	11,858	8,967
Construction in progress	480	320
Total	52,670	27,699
Less: accumulated depreciation	10,953	9,222
Premises and equipment, net	$41,717	$18,477

Depreciation expense was $2.1 million for the year ended December 31, 2018 and $1.6 million for each of the years ended December 31, 2017 and 2016.

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9. DEPOSITS

Time deposits that meet or exceed the Federal Deposit Insurance Corporation (the "FDIC") insurance limit of $250 thousand at December 31, 2018 and December 31, 2017 were $509.3 million and $227.4 million, respectively.

Scheduled maturities of time deposits for the next five years are as follows (dollars in thousands):

Within one year	$793,284
After one but within two years	161,877
After two but within three years	89,942
After three but within four years	92,790
After four but within five years	68,598
Total	$1,206,491

The Company has $261.1 million and $314.8 million of brokered deposits, and there were no major concentrations of deposits with any one depositor at December 31, 2018 and 2017, respectively. Included in the December 31, 2017 amount were reciprocal deposits that the Company placed through the Certificates of Deposits Account Registry Service (CDARS) Network of $68.4 million.

Related party deposits from principal officers, directors and their affiliates at December 31, 2018 and 2017 were $9.6 million and $14.8 million, respectively.

10. BORROWINGS AND BORROWING CAPACITY

The Company has an available line of credit with the FHLB of Dallas, which allows the Company to borrow on a collateralized basis. FHLB advances are used to manage liquidity as needed. The advances are secured by a blanket lien on certain loans. Maturing advances are replaced by drawing on available cash, making additional borrowings or through increased customer deposits. At December 31, 2018, the Company had total borrowing capacity of $1.06 billion, of which $765.4 million was available under this agreement and $296.5 million was outstanding. FHLB advances of $225.0 million were outstanding at December 31, 2018, at a weighted average rate of 2.57%. Letters of credit were $71.5 million at December 31, 2018, of which $8.8 million expired in January 2019, $10.2 million expired in February 2019, $7.1 million will expire in April 2019, $7.1 million will expire in May 2019, $5.5 million will expire in August 2019, $25.0 million will expire in October 2019, $6.3 million will expire in December 2019 and $1.5 million will expire in January 2020.

On December 28, 2018, the Company amended its revolving credit agreement to increase the maximum commitment to advance funds to $45.0 million which will reduce annually by $7.5 million beginning in December 2020 and on each December 22nd for the following years thereafter. The Company is required to repay any outstanding balance in excess of the then-current maximum commitment amount. The revised agreement will mature in December 2025 and is secured by 100% of the capital stock of the Bank. The credit agreement contains certain restrictive covenants. At December 31, 2018, the Company believes it was in compliance with all such debt covenants and had not been made aware of any noncompliance by the lender. The interest rate on the debt is the Prime Rate minus 25 basis points, or

5.00%, at December 31, 2018, and is paid quarterly. Scheduled principal maturities are as follows (dollars in thousands):

2019	$—
2020	—
2021	—
2022	—
2023 and thereafter	569
Total	$569

11. SUBORDINATED DEBT

Junior Subordinated Debentures

On January 1, 2015, the Company acquired F&M Bancshares and assumed Farmers & Merchants Capital Trust II and Farmers & Merchants Capital Trust III with an aggregate original principal amount of $11.3 million and a current fair value of $9.4 million at December 31, 2018. At acquisition, the Company recorded a discount of $2.5 million on the debentures. The difference between the carrying value and contractual balance will be recognized as a yield adjustment over the remaining term for the debentures. Each of the trusts is a capital or statutory business trust organized for the sole purpose of issuing trust securities and investing the proceeds in the Company's junior subordinated debentures. The preferred trust securities of each trust represent preferred beneficial interests in the

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assets of the respective trusts and are subject to mandatory redemption upon payment of the junior subordinated debentures held by the trust. The common securities of each trust are wholly owned by the Company. Each trust's ability to pay amounts due on the trust preferred securities is solely dependent upon the Company making payment on the related junior subordinated debentures. The debentures, which are the only assets of each trust, are subordinate and junior in right of payment to all of the Company's present and future senior indebtedness. The Company has fully and unconditionally guaranteed each trust's obligations under the trust securities issued by such trust to the extent not paid or made by each trust, provided such trust has funds available for such obligations. The junior subordinated debentures are included in Tier 1 capital under current regulatory guidelines and interpretations.

Under the provisions of each issue of the debentures, the Company has the right to defer payment of interest on the debentures at any time, or from time to time, for periods not exceeding five years. If interest payments on either issue of the debentures are deferred, the distributions on the applicable trust preferred securities and common securities will also be deferred.

A summary of pertinent information related to the Company's issuances of junior subordinated debentures outstanding at December 31, 2018 is set forth in the table below:

Description	Issuance Date	Trust Preferred Securities Outstanding	Interest Rate (1)	Junior Subordinated Debt Owed to Trusts	Maturity Date (2)
Farmers & Merchants Capital Trust II	November 13, 2003	$ 7,500	3 month LIBOR + 3.00%	$ 7,732	November 8, 2033
Farmers & Merchants Capital Trust III	June 30, 2005	3,500	3 month LIBOR + 1.80%	3,609	July 7, 2035
				$ 11,341	

(1) The 3-month LIBOR in effect as of December 31, 2018 was 2.7902%.
(2) All debentures are currently callable.

Subordinated Notes

In December 2017, the Bank completed the issuance, through a private placement, of $40.0 million aggregate principal amount of Fixed-to-Floating Rate Subordinated Notes (the "Notes") due December 15, 2027. The Notes were issued at a price equal to 100% of the principal amount, resulting in net proceeds to the Bank of $39.4 million. The Bank used the net proceeds from the offering to support its growth and for general corporate purposes. The Notes are intended to qualify as Tier 2 capital for bank regulatory purposes.

The Notes bear a fixed interest rate of 5.25% per annum until (but excluding) December 15, 2022, payable semi-annually in arrears. From December 15, 2022, the Notes will bear a floating rate of interest equal to 3-Month LIBOR + 3.03% until the Notes mature on December 15, 2027, or such earlier redemption date, payable quarterly in arrears. The Notes will be redeemable by the Bank, in whole or in part, on or after December 15, 2022 or, in whole but not in part, upon the occurrence of certain specified tax events, capital events or investment company events. Any redemption will be at a redemption price equal to 100% of the principal amount of Notes being redeemed, plus accrued and unpaid interest, and will be subject to, and require, prior regulatory approval. The Notes are not subject to redemption at the option of the holders.

12. INCOME TAXES

The components of the provision for federal income taxes are as follows:

	Years Ended December 31,		
	2018	2017	2016
	(Dollars in thousands)		
Current	$8,204	$8,320	$11,162
Deferred	(256)	427	(1,608)
Total	$7,948	$8,747	$9,554

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Reported income tax expense differs from the amounts computed by applying the U.S. federal statutory income tax rate to income before income taxes for the years ended December 31, 2018, 2017 and 2016 due to the following:

	Years Ended December 31,		
	2018	2017	2016
	(Dollars in thousands)		
Taxes calculated at statutory rate	$9,504	$9,233	$11,342
Increase (decrease) resulting from:			
Stock based compensation	(400)	(755)	67
Effect of tax exempt income	(1,284)	(2,328)	(1,929)
Provisional deferred tax adjustment related to reduction in U.S. federal statutory income tax rate	—	2,621	—
Other, net	128	(24)	74
Total	$7,948	$8,747	$9,554

Income tax expense for 2018 was impacted by the reduction in the U.S. federal statutory income tax rate to 21% under the Tax Cuts and Jobs Act, which was enacted on December 22, 2017. During 2017, as a result of the new law, the Company recognized a provisional net tax expense totaling $2.6 million. During 2016, the Company adopted a new accounting standard that requires the income tax effects associated with stock-based compensation to be recognized as a component of income tax expense. The Company recognized net tax benefits related to stock-based compensation totaling $587 thousand in 2018 and $1.1 million in 2017.

Year-end deferred taxes are presented in the table below. As a result of the Tax Cuts and Jobs Act enacted on December 22, 2017, deferred taxes as of December 31, 2018 and 2017 are based on the 21% and 35% federal income tax rate, respectively.

Deferred tax assets and liabilities are as follows:

	As of December 31,	
	2018	2017
	(Dollars in thousands)	
Deferred tax assets:		
Allowance for credit losses	$5,898	$5,284
Net unrealized loss on available for	761	—

sale securities		
Deferred compensation	366	177
Total deferred tax assets	7,025	5,461
Deferred tax liabilities:		
Core deposit intangible and other purchase accounting adjustments	(2,718)	(1,100)
Net unrealized gain on available for sale securities	—	(65)
Premises and equipment basis difference	(2,035)	(321)
Total deferred tax liabilities	(4,753)	(1,486)
Net deferred tax assets	$2,272	$3,975

Interest and penalties related to tax positions are recognized in the period in which they begin accruing or when the entity claims the position that does not meet the minimum statutory thresholds. The Company does not have any uncertain tax positions and does not have any interest and penalties recorded in the income statement for the years ended December 31, 2018, 2017 and 2016. The Company is no longer subject to examination by the US Federal Tax Jurisdiction for the years prior to 2015.

13. STOCK BASED COMPENSATION

At December 31, 2018, the Company had two stock-based employee compensation plans with awards outstanding. In connection with the acquisition of Post Oak Bancshares, Inc., on October 1, 2018, the Company assumed the Post Oak Bancshares, Inc. Stock Option Plan, under which no additional awards will be issued. The Company accounts for stock based employee compensation plans using the fair value-based method of accounting. The Company recognized total stock based compensation expense of $1.7 million, $1.8 million and $1.5 million for the years ended December 31, 2018, 2017 and 2016, respectively. During 2015, the Company's Board of Directors and shareholders approved the 2015 Amended and Restated Stock Awards and Incentive Plan (the "Plan") covering certain awards of stock-based compensation to key employees and directors of the Company. The Plan was

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ALLEGIANCE BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

amended in 2017 as the shareholders authorized a maximum aggregate number of shares of stock to be issued of 1,900,000, any or all of which may be issued through incentive stock options and restricted stock.

Stock Options

Options to purchase a total of 1,309,231 shares of Company stock have been granted as of December 31, 2018. Under the Plan, options are exercisable up to 10 years from the date of the grant and, dependent on the terms of the applicable award agreement generally vest 4 years after the date of grant. The fair value of stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model.

As part of the Post Oak acquisition, all outstanding Post Oak options were assumed by Allegiance and converted using the 0.7017 exchange ratio to 299,352 options at a weighted average exercise price of $12.83 per option.

The expected volatility was determined based on historical volatilities of Allegiance's common stock. The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding and takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. The Black-Scholes pricing model utilizes certain assumptions noted in the table below.

	2018	2017	2016
Risk-free interest rate	2.72 %	2.40 %	1.76 %
Expected term	10.00	10.00	10.00
Expected stock price volatility	29.26%	29.70%	34.60%
Dividend yield	—	—	—

A summary of the activity in the stock option plans during the years ended December 31, 2018 and 2017 is set forth below:

	Number of Options (In thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Options outstanding, January 1, 2017	935	$ 18.21	6.23	$ 16,773
Options granted	64	36.88		
Options exercised	(215)	17.50		
Options forfeited	(9)	23.35		
Options outstanding, December 31, 2017	775	$ 19.94	5.72	$ 13,718
Options granted	4	40.40		
Options assumed	299	12.83		

Options exercised	(244)	13.88		
Options forfeited	(32)	29.53		
Options outstanding, December 31, 2018	802	$ 18.88	4.61	$ 10,830
Options vested and exercisable, December 31, 2018	677	$ 17.32	4.09	$ 10,193

The Company expects all outstanding options at December 31, 2018 to vest.

Information related to the stock option plans during each year is as follows:

	2018	2017	2016
	(In thousands)		
Intrinsic value of options exercised	$3,254	$3,371	$1,128
Cash received from option exercises	3,393	3,743	1,782
Weighted average fair value of options granted	$18.00	$16.55	$10.51

As of December 31, 2018, there was $950 thousand of total unrecognized compensation cost related to nonvested stock options granted under the plans. The cost is expected to be recognized over a weighted-average period of 1.41 years.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Restricted Stock Awards

The Company has issued 226,529 restricted stock awards under the Plan as of December 31, 2018. During 2016, the Company awarded 15,401 shares of restricted stock with a weighted average grant date fair value of $17.52. During 2017, the Company awarded 28,106 shares of restricted stock with a weighted average grant date fair value of $36.17. During 2018, the Company awarded 122,127 shares of restricted stock with a weighted average grant date fair value of $39.04. The shares of restricted stock generally vest over a period of 4 years and are considered outstanding at the date of issuance. The Company accounts for shares of restricted stock by recording the fair value of the grant on the award date as compensation expense over the vesting period.

A summary of the activity of the nonvested shares of restricted stock as of December 31, 2018 and 2017 including changes during the years then ended is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
	(Shares in thousands)	
Nonvested share awards outstanding, January 1, 2017	24	$ 18.31
Share awards granted	28	36.17
Share awards vested	(11)	18.32
Unvested share awards forfeited or cancelled	—	—
Nonvested share awards outstanding, December 31, 2017	41	$ 30.46
Share awards granted	122	39.04
Share awards vested	(20)	30.12
Unvested share awards forfeited or cancelled	—	—
Nonvested share awards outstanding, December 31, 2018	143	$ 37.48

At December 31, 2018, there was $4.8 million of unrecognized compensation expense related to the restricted stock awards which is expected to be recognized over a weighted-average period of 3.59 years. The total fair value of restricted stock awards that fully vested during the years ended December 31, 2018, 2017 and 2016 was approximately $621 thousand, $203 thousand and $172 thousand, respectively.

14. OTHER EMPLOYEE BENEFITS

401(k) benefit plan

The Company has a 401(k) benefit plan whereby participants may contribute a percentage of their compensation. The Company matches 50% of an employee's contributions up to 6% of the employee’s compensation, for a maximum match of 3% of compensation. Matching contribution expense as of December 31, 2018, 2017 and 2016 was $962 thousand, $789 thousand and $637 thousand, respectively.

Profit sharing plan

The financial statements include an accrual for $2.5 million, $1.5 million and $1.7 million for a contribution to the plan as a profit sharing contribution for the years ended December 31, 2018, 2017 and 2016, respectively.

Employee Stock Purchase Plan

The Company offers its employees an opportunity to purchase shares of Allegiance’s common stock, pursuant to the terms of the Allegiance Bancshares, Inc. Amended and Restated Employee Stock Purchase Plan, as amended (“ESPP”). The ESPP was adopted by the Board of Directors to provide employees with an opportunity to purchase shares of Allegiance in order to provide employees a more direct opportunity to participate in the Company’s growth. The Company allows employees to purchase shares at a 15% discount to market value and thus incurs stock based compensation expense for the fair value of the discount given. The Company recognized total stock based compensation expense of $48 thousand, $144 thousand and $90 thousand for the years ended December 31, 2018, 2017, and 2016 respectively.

ALLEGIANCE BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

15. OFF-BALANCE SHEET ARRANGEMENTS, COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Company enters into various transactions, which, in accordance with accounting principles generally accepted in the United States are not included in the Company's consolidated balance sheets. The Company enters into these transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and standby and commercial letters of credit, which involve to varying degrees elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The Company uses the same credit policies in making commitments and conditional obligations as it does for on balance sheet instruments.

Commitments to Extend Credit

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being fully drawn upon, the total commitment amounts disclosed do not necessarily represent future cash funding requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The Company minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of the allowance for credit losses. The amount and type of collateral, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the customer.

Standby Letters of Credit

Standby letters of credit are written conditional commitments issued by the Company to guarantee the performance of a customer to a third party. In the event of nonperformance by the customer, the Company has the rights to the underlying collateral. The credit risk to the Company in issuing letters of credit is essentially the same as that involved in extending loan facilities to its customers. The Company's policy for obtaining collateral, and the nature of such collateral, is essentially the same as that involved in making commitments to extend credit.

The contractual amounts of financial instruments with off-balance sheet risk are as follows:

	December 31, 2018		December 31, 2017	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
	(Dollars in thousands)			
Commitments to extend credit	$471,440	$530,546	$369,573	$250,467
Standby letters of credit	14,217	9,067	15,445	1,725
Total	$485,657	$539,613	$385,018	$252,192

Commitments to make loans are generally made for periods of 120 days or less. As of December 31, 2018, the fixed rate loan commitments have interest rates ranging from 1.95% to 8.70% with a weighted average maturity and rate of

2.49 years and 5.26%, respectively.

Leases

The following table presents a summary of non-cancelable future operating lease commitments as of December 31, 2018 (dollars in thousands):

2019	$2,559
2020	1,987
2021	1,731
2022	1,510
2023	1,042
Thereafter	4,083
	$12,912

It is expected that in the normal course of business, expiring leases will be renewed or replaced by leases on other property. Rent expense under all noncancelable operating lease obligations aggregated approximately $2.9 million, $2.8 million and $2.7 million for the years ended December 31, 2018, 2017 and 2016, respectively.

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ALLEGIANCE BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

16. REGULATORY CAPITAL MATTERS

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations involve quantitative measures of assets, liabilities and certain off balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weightings and other factors. Failure to meet minimum capital requirements can initiate actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. The final rules implementing Basel Committee on Banking Supervision's capital guideline for U.S. Banks (Basel III Rules) became effective for the Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and were fully phased in on January 1, 2019. Management believes as of December 31, 2018 and 2017, the Company and the Bank met all capital adequacy requirements to which they were subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited as is asset growth and expansion, and capital restoration plans are required. At year-end 2018 and 2017, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

ALLEGIANCE BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is a summary of the Company’s and the Bank’s actual and required capital ratios at December 31, 2018 and 2017:

	Actual Amount	Ratio	For Capital Adequacy Purposes Amount	Ratio	Minimum Required Plus Capital Conservation Buffer Amount	Ratio	To Be Categorized As Well Capitalized Under Prompt Corrective Action Provisions Amount	Ratio
	(Dollars in thousands)							
ALLEGIANCE BANCSHARES, INC.								
(Consolidated)								
As of December 31, 2018								
Total Capital (to risk weighted assets)	$531,453	13.70%	$310,295	8.00%	$383,020	9.875%	N/A	N/A
Common Equity Tier 1 Capital (to risk weighted assets)	456,223	11.76%	174,541	4.50%	247,266	6.375%	N/A	N/A
Tier I Capital (to risk weighted assets)	465,637	12.01%	232,721	6.00%	305,446	7.875%	N/A	N/A
Tier I Capital (to average tangible assets)	465,637	10.61%	175,621	4.00%	175,621	4.000%	N/A	N/A
As of December 31, 2017								
Total Capital (to risk weighted assets)	$336,829	13.43%	$200,687	8.00%	$232,044	9.250%	N/A	N/A
Common Equity Tier 1 Capital (to risk weighted assets)	264,521	10.54%	112,886	4.50%	144,244	5.750%	N/A	N/A
Tier I Capital (to risk weighted assets)	273,825	10.92%	150,515	6.00%	181,872	7.250%	N/A	N/A
Tier I Capital	273,825	9.84 %	111,274	4.00%	111,274	4.000%	N/A	N/A

(to average tangible assets)								
ALLEGIANCE BANK								
As of December 31, 2018								
Total Capital (to risk weighted assets)	$524,660	13.53%	$310,179	8.00%	$382,877	9.875%	$ 387,724	10.00 %
Common Equity Tier 1 Capital (to risk weighted assets)	458,844	11.83%	174,476	4.50%	247,174	6.375%	252,021	6.50 %
Tier I Capital (to risk weighted assets)	458,844	11.83%	232,634	6.00%	305,333	7.875%	310,179	8.00 %
Tier I Capital (to average tangible assets)	458,844	10.45%	175,552	4.00%	175,552	4.000%	219,440	5.00 %
As of December 31, 2017								
Total Capital (to risk weighted assets)	$331,872	13.24%	$200,596	8.00%	$231,939	9.250%	$ 250,745	10.00 %
Common Equity Tier 1 Capital (to risk weighted assets)	268,868	10.72%	112,835	4.50%	144,179	5.750%	162,985	6.50 %
Tier I Capital (to risk weighted assets)	268,868	10.72%	150,447	6.00%	181,790	7.250%	200,596	8.00 %
Tier I Capital (to average tangible assets)	268,868	9.67 %	111,230	4.00%	111,230	4.000%	139,037	5.00 %

Dividend Restrictions

Allegiance's principal source of funds for dividend payments is dividends received from the Bank. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. In addition, Allegiance's credit agreement with another financial institution also limits its ability to pay dividends. Under applicable banking regulations, the amount of dividends that may be paid by the Bank in any calendar year is limited to the current year’s net profits combined with the retained net profits of the preceding two years, subject to the capital requirements described above.

ALLEGIANCE BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

17. EARNINGS PER COMMON SHARE

Diluted earnings per common share is computed using the weighted-average number of common shares determined for the basic earnings per common share computation plus the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock using the treasury stock method. Outstanding stock options issued by the Company represent the only dilutive effect reflected in diluted weighted average shares. Restricted shares are considered outstanding at the date of grant, accounted for as participating securities and are included in basic and diluted weighted average common shares outstanding.

	Year Ended December 31,					
	2018		2017		2016	
	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount
	(Amounts in thousands, except per share data)					
Net income attributable to shareholders	$37,309		$17,632		$22,851	
Basic:						
Weighted average shares outstanding	15,485	$ 2.41	13,125	$ 1.34	12,873	$ 1.78
Diluted:						
Add incremental shares for:						
Dilutive effect of stock option exercises	288		333		201	
Total	15,773	$ 2.37	13,458	$ 1.31	13,074	$ 1.75

Stock options for 69 thousand and 28 thousand shares were not considered in computing diluted earnings per share as of December 31, 2018 and 2017, respectively, because they were antidilutive. All stock options as of December 31, 2016 were dilutive and considered in computing diluted earnings per share.

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ALLEGIANCE BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

18. PARENT COMPANY ONLY FINANCIAL STATEMENTS

ALLEGIANCE BANCSHARES, INC

(PARENT COMPANY ONLY)

CONDENSED BALANCE SHEETS

	December 31, 2018	2017
	(Dollars in thousands)	
ASSETS		
Cash and due from banks	$6,780	$4,857
Investment in subsidiary	705,947	311,553
Other assets	1,026	791
TOTAL	$713,753	$317,201
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Other borrowed funds	$492	$569
Subordinated debentures	9,414	9,304
Accrued interest payable and other liabilities	862	463
Total liabilities	10,768	10,336
SHAREHOLDERS' EQUITY:		
Common stock	21,938	13,227
Capital surplus	571,804	218,408
Retained earnings	112,131	74,894
Accumulated other comprehensive (loss) income	(2,888)	336
Total shareholders' equity	702,985	306,865
TOTAL	$713,753	$317,201

ALLEGIANCE BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

ALLEGIANCE BANCSHARES, INC

(PARENT COMPANY ONLY)

CONDENSED STATEMENTS OF INCOME

	For the Years Ended December 31,		
	2018	2017	2016
	(Dollars in thousands)		
OPERATING INCOME:			
Other income	$ 16	$ 13	$ 11
Total income	16	13	11
OPERATING EXPENSE:			
Interest expense on borrowed funds	38	33	30
Other expenses	1,692	1,465	1,204
Total operating expense	1,730	1,498	1,234
INCOME BEFORE INCOME TAX BENEFIT AND EQUITY IN UNDISTRIBUTED EARNINGS OF SUBSIDIARIES	(1,714)	(1,485)	(1,223)
INCOME TAX BENEFIT	360	756	428
INCOME BEFORE EQUITY IN UNDISTRIBUTED EARNINGS OF SUBSIDIARIES	(1,354)	(729)	(795)
EQUITY IN UNDISTRIBUTED EARNINGS OF SUBSIDIARIES	38,663	18,361	23,646
NET INCOME	$ 37,309	$ 17,632	$ 22,851

ALLEGIANCE BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

ALLEGIANCE BANCSHARES, INC

(PARENT COMPANY ONLY)

CONDENSED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,		
	2018	2017	2016
	(Dollars in thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 37,309	$ 17,632	$ 22,851
Adjustments to reconcile net income to net cash used in operating activities:			
Equity in undistributed earnings of subsidiaries	(38,663)	(18,361)	(23,646)
Net amortization of discount on subordinated debentures	110	107	107
Increase in other assets	(236)	(378)	(399)
Increase (decrease) in accrued interest payable and other liabilities	279	(377)	186
Net cash used in operating activities	(1,201)	(1,377)	(901)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Capital investment in bank subsidiary	—	(21,000)	—
Net cash used in investing activities	—	(21,000)	—
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of common stock	3,552	4,248	2,006
Proceeds from initial public offering	—	—	—
Stock based compensation expense	1,685	1,780	1,501
(Repurchase) issuance of treasury stock	(2,113)	—	38
Net cash provided by financing activities	3,124	6,028	3,545
NET CHANGE IN CASH AND CASH EQUIVALENTS	1,923	(16,349)	2,644
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	4,857	21,206	18,562
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 6,780	$ 4,857	$ 21,206

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ALLEGIANCE BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

19. QUARTERLY FINANCIAL DATA (UNAUDITED)

	Interest Income	Net Interest Income	Net Income Attributable to Common Shareholders	Earnings Per Share[1] Basic	Earnings Per Share[1] Diluted
	(Dollars in thousands, except per share data)				
2018					
First quarter	$32,391	$26,889	$ 7,711	$0.58	$ 0.57
Second quarter	34,193	27,816	7,556	0.57	0.55
Third quarter	35,336	28,036	8,879	0.66	0.65
Fourth quarter	56,303	45,838	13,163	0.60	0.59
2017					
First quarter	$27,512	$24,128	$ 6,047	$0.46	$ 0.45
Second quarter	28,987	25,107	5,395	0.41	0.40
Third quarter	30,901	26,997	2,986	0.23	0.22
Fourth quarter	32,038	27,436	3,204	0.24	0.24

(1) Earnings per share are computed independently for each of the quarters presented and therefore may not total earnings per share for the year

20. SUBSEQUENT EVENT

On February 1, 2019, the Bank completed the previously announced acquisition of LoweryBank, the Sugar Land location of Huntington State Bank. In connection with the purchase, the Bank acquired approximately $44.0 million in loans and $15.0 million in customer deposits. The Bank consolidated its existing Sugar Land bank office into this new bank office location, which was less than one mile away. The acquisition of LoweryBank will be accounted for under the acquisition method of accounting in accordance with ASC Topic 805 – Business Combinations. Allegiance's assessment of the fair value of assets acquired and liabilities assumed as of the acquisition date is incomplete at the time of this filing; therefore, certain disclosure have been omitted. Allegiance expects to recognize goodwill in the transaction, which is expected to be nondeductible for tax purposes.