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Allegiance Bancshares, Inc.
Form 10-Q
November 10, 2016

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2016
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO
COMMISSION FILE NUMBER: 001-37585

Allegiance Bancshares, Inc.
(Exact name of registrant as specified in its charter)

Texas 26-3564100
(State or other jurisdiction (I.R.S. Employer
of incorporation or organization) Identification No.)
8847 West Sam Houston Parkway, N., Suite 200
Houston, Texas 77040
(Address of principal executive offices, including zip code)
(281) 894-3200
(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer (Do not check if a smaller reporting company) Smaller Reporting Company

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

As of November 3, 2016, there were 12,905,068 outstanding shares of the registrant’s Common Stock, par value \$1.00 per share.

ALLEGIANCE BANCSHARES, INC.
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SEPTEMBER 30, 2016

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PART I—FINANCIAL INFORMATION

ITEM 1. INTERIM CONSOLIDATED FINANCIAL STATEMENTS

ALLEGIANCE BANCSHARES, INC.

CONSOLIDATED BALANCE SHEETS

	September 30, 2016 (Unaudited)	December 31, 2015 (Unaudited)
	(Dollars in thousands, except share data)	
ASSETS		
Cash and due from banks	\$ 133,053	\$ 63,380
Interest-bearing deposits at other financial institutions	92,029	85,051
Total cash and cash equivalents	225,082	148,431
Available for sale securities, at fair value	310,033	165,097
Loans held for sale	—	27,887
Loans held for investment	1,830,722	1,653,165
Less: allowance for loan losses	(17,185)	(13,098)
Loans, net	1,813,537	1,667,954
Accrued interest receivable	6,962	6,518
Premises and equipment, net	17,811	18,471
Other real estate owned	1,138	—
Federal Home Loan Bank stock	11,938	2,569
Branch assets held for sale	—	1,398
Bank owned life insurance	21,684	21,211
Goodwill	39,389	39,389
Core deposit intangibles, net	4,250	5,230
Other assets	10,078	8,311
TOTAL ASSETS	\$ 2,461,902	\$ 2,084,579
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	\$ 604,278	\$ 620,320
Interest-bearing		
Demand	112,009	97,826
Money market and savings	504,481	431,305
Certificates and other time	680,111	609,682
Total interest-bearing deposits	1,296,601	1,138,813
Total deposits	1,900,879	1,759,133
Accrued interest payable	259	124
Short-term borrowings	61,000	50,000
Other borrowed funds	200,569	569
Subordinated debentures	9,169	9,089
Other liabilities	8,931	7,174
Total liabilities	2,180,807	1,826,089
COMMITMENTS AND CONTINGENCIES (See Note 12)		
STOCKHOLDERS' EQUITY:		
	—	—

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Preferred stock, \$1 par value; 1,000,000 shares authorized; there were no shares issued and outstanding of Series A or Series B, each has a \$1,000 liquidation value		
Common stock, \$1 par value; 40,000,000 shares authorized; 12,905,068 shares issued and outstanding at September 30, 2016 and 12,814,696 shares issued and 12,812,985 shares outstanding at December 31, 2015	12,905	12,815
Capital surplus	211,349	209,285
Retained earnings	51,491	34,411
Accumulated other comprehensive income	5,350	2,017
Less: Treasury stock, at cost, 1,711 shares at December 31, 2015. There were no treasury shares outstanding at September 30, 2016.	—	(38)
Total stockholders' equity	281,095	258,490
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$2,461,902	\$2,084,579
See condensed notes to interim consolidated financial statements.		

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ALLEGIANCE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three Months		Nine Months	
	Ended September		Ended September	
	30,	30,	30,	30,
	2016	2015	2016	2015
	(Dollars in thousands, except per share data)			
INTEREST INCOME:				
Loans, including fees	\$24,057	\$21,627	\$69,124	\$63,012
Securities:				
Taxable	607	252	1,329	694
Tax-exempt	1,505	723	3,402	1,441
Deposits in other financial institutions	150	43	442	167
Total interest income	26,319	22,645	74,297	65,314
INTEREST EXPENSE:				
Demand, money market and savings deposits	651	545	1,764	1,582
Certificates and other time deposits	1,872	1,287	5,097	3,642
Short-term borrowings	63	47	308	49
Subordinated debentures	123	114	360	439
Other borrowed funds	201	245	326	691
Total interest expense	2,910	2,238	7,855	6,403
NET INTEREST INCOME	23,409	20,407	66,442	58,911
Provision for loan losses	2,214	1,530	4,569	3,633
Net interest income after provision for loan losses	21,195	18,877	61,873	55,278
NONINTEREST INCOME:				
Nonsufficient funds fees	175	179	483	512
Service charges on deposit accounts	182	163	500	514
Gain on sale of branch assets	—	—	2,050	—
Gain (loss) on sales of other real estate	60	1	60	(5)
Gain on sales of loans	—	235	—	235
Bank owned life insurance income	154	167	473	433
Other	703	456	2,224	1,325
Total noninterest income	1,274	1,201	5,790	3,014
NONINTEREST EXPENSE:				
Salaries and employee benefits	9,781	8,996	28,231	26,419
Net occupancy and equipment	1,260	1,289	3,706	3,647
Depreciation	404	414	1,236	1,190
Data processing and software amortization	655	841	1,930	2,294
Professional fees	442	343	1,377	1,220
Regulatory assessments and FDIC insurance	396	296	1,096	990
Core deposit intangibles amortization	196	207	590	622
Communications	264	300	818	992
Advertising	228	188	626	510
Other	1,269	1,027	3,461	3,025
Total noninterest expense	14,895	13,901	43,071	40,909
INCOME BEFORE INCOME TAXES	7,574	6,177	24,592	17,383

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Provision for income taxes	2,103	1,957	7,512	5,809
NET INCOME	5,471	4,220	17,080	11,574
Preferred stock dividends	—	173	—	559
NET INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS	\$5,471	\$4,047	\$17,080	\$11,015
EARNINGS PER COMMON SHARE:				
Basic	\$0.42	\$0.41	\$1.33	\$1.12
Diluted	\$0.42	\$0.40	\$1.31	\$1.10

See condensed notes to interim consolidated financial statements.

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ALLEGIANCE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
	2016	2015	2016	2015
	(Dollars in thousands)			
Net income	\$5,471	\$4,220	\$17,080	\$11,574
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	(2,308)	2,162	5,127	1,197
Reclassification of amount realized through the sale of securities	—	—	—	—
Total other comprehensive (loss) income	(2,308)	2,162	5,127	1,197
Deferred tax expense (benefit) related to other comprehensive (loss) income	808	(756)	(1,794)	(427)
Other comprehensive (loss) income, net of tax	(1,500)	1,406	3,333	770
Comprehensive income	\$3,971	\$5,626	\$20,413	\$12,344
See condensed notes to interim consolidated financial statements.				

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ALLEGIANCE BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Unaudited)

	Preferred Stock	Common Stock	Capital	Retained	Accumulated	Treasury	Total
	Shares	Amount	Surplus	Earnings	Other Comprehensive Income (Loss)	Stock	Stockholders' Equity
(In thousands, except share data)							
BALANCE AT JANUARY 1, 2015	—	\$ — 7,477,309	\$7,477	\$104,568	\$19,184	\$ 549	\$ — \$ 131,778
Net income				11,574			11,574
Other comprehensive loss					770		770
Common stock issued in connection with the exercise of stock options and restricted stock awards		3,983	4	7			11
Repurchase of treasury stock						(51)	(51)
Issuance of common stock		4,884	5	103		14	122
Common stock issued in connection with the acquisition of F&M Bancshares, Inc.		2,338,520	2,339	49,108			51,447
Preferred stock issued in connection with the acquisition of F&M Bancshares, Inc.	11,550	11,550					11,550
Redemption of preferred stock	(11,550)	(11,550)					(11,550)
Preferred stock dividends					(559)		(559)
Stock based compensation expense			951				951
BALANCE AT SEPTEMBER 30, 2015	—	\$ — 9,824,696	\$9,825	\$154,737	\$30,199	\$ 1,319	\$ (37) \$ 196,043
BALANCE AT JANUARY 1, 2016	—	\$ — 12,814,696	\$12,815	\$209,285	\$34,411	\$ 2,017	\$ (38) \$ 258,490
Net income				17,080			17,080
Other comprehensive income					3,333		3,333
Common stock issued in connection with the exercise of stock options and restricted stock awards		90,372	90	986			1,076
Issuance of treasury stock						38	38
Stock based compensation expense				1,078			1,078

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BALANCE AT
SEPTEMBER 30, 2016 — \$ — 12,905,068 \$12,905 \$211,349 \$51,491 \$ 5,350 \$— \$281,095

See condensed notes to interim consolidated financial statements.

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ALLEGIANCE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30,	
	2016	2015
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$17,080	\$11,574
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and core deposit intangibles amortization	1,826	1,812
Provision for loan losses	4,569	3,633
Net amortization of premium on investments	2,048	815
Bank owned life insurance	(473)	(433)
Net accretion of discount on loans	(1,213)	(2,968)
Net amortization of discount on subordinated debentures	80	191
Net amortization of discount on certificates of deposit	(228)	(621)
Net loss on sales or write down of premises, equipment and other real estate	(60)	5
Net gain on sale of branch assets	(2,050)	—
Net gain on sales of loans	—	(235)
Federal Home Loan Bank stock dividends	(60)	(2)
Stock based compensation expense	1,078	951
Increase in accrued interest receivable and other assets	(3,461)	(227)
Increase in accrued interest payable and other liabilities	2,156	832
Net cash provided by operating activities	21,292	15,327
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities and principal paydowns of available for sale securities	2,564,916	1,213,992
Proceeds from sales of available for sale securities	—	14,748
Purchase of available for sale securities	(2,706,773)	(1,283,220)
Net change in total loans	(168,108)	(209,271)
Proceeds from sales of loans	—	2,074
Purchase of bank premises and equipment	(590)	(1,891)
Purchase of bank owned life insurance	—	(10,000)
Net purchases of Federal Home Loan Bank stock	(9,309)	(7,220)
Net cash paid for the sale of branch assets	(5,250)	—
Net cash and cash equivalents acquired in the purchase of F&M Bancshares, Inc.	—	106,486
Net cash used in investing activities	(325,114)	(174,302)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (decrease) increase in noninterest-bearing deposits	(9,514)	1,449
Net increase in interest-bearing deposits	177,873	31,603
Paydowns of long-term borrowings	—	(18,000)
Proceeds from long-term borrowings	200,000	18,000
Paydowns of short-term borrowings	(20,000)	—
Proceeds from short-term borrowings	31,000	115,000
Preferred stock dividends	—	(559)
Redemption of preferred stock	—	(11,550)
Proceeds from the issuance of common stock, stock option exercises, restricted stock awards and the ESPP	1,076	133

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Issuance (repurchase) of treasury stock	38	(51)
Net cash provided by financing activities	380,473	136,025
NET CHANGE IN CASH AND CASH EQUIVALENTS	76,651	(22,950)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	148,431	167,540
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$225,082	\$144,590
NONCASH ACTIVITIES:		
Acquired loans transferred to loans held for sale	\$—	\$33,409
Acquired premises and equipment and accrued interest receivable transferred to branch assets held for sale	—	1,662
SUPPLEMENTAL INFORMATION:		
Income taxes paid	\$9,100	\$5,600
Interest paid	2,541	5,675
See Note 2 regarding non-cash transactions included in the F&M Bancshares, Inc. acquisition		
See condensed notes to interim consolidated financial statements.		

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ALLEGIANCE BANCSHARES, INC.
CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2016
(Unaudited)

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

Nature of Operations-Allegiance Bancshares, Inc. (“Allegiance”) and its wholly-owned subsidiary, Allegiance Bank, a Texas state bank, (the “Bank”, and together with Allegiance, collectively referred to as the “Company”) provide commercial and retail loans and commercial banking services. The Company derives substantially all of its revenues and income from the operation of the Bank. 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 16 offices in Houston, Texas and the surrounding region. 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.

Basis of Presentation-The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with United States Generally Accepted Accounting Principles (GAAP) for interim financial information and in accordance with guidance provided by the Securities and Exchange Commission. Accordingly, the condensed consolidated financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments considered necessary for a fair presentation of the financial position, results of operations and cash flows of the Company on a consolidated basis, and all such adjustments are of a normal recurring nature. Transactions with Allegiance have been eliminated. The condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2015. Operating results for the three and nine months ended September 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. Furthermore, the acquisition of F&M Bancshares, Inc. during the first quarter of 2015 may impact the comparability of year to date 2016 versus year to date 2015 comparable information.

Significant Accounting and Reporting Policies

The Company’s significant accounting and reporting policies can be found in Note 1 of the Company’s annual financial statements included the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

New Accounting Standards

Adoption of New Accounting Standards

On January 1, 2016, the Company adopted ASU 2015-16, “Business Combinations (Topic 805) – Simplifying the Accounting for Measurement-Period Adjustments.” ASU 2015-16 requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The acquirer must record, in the same period’s financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. Additionally, the entity is required to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. The adoption of ASU 2015-16 did not have a significant impact on the Company’s financial statements.

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ALLEGIANCE BANCSHARES, INC.
CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2016
(Unaudited)

Newly Issued But Not Yet Effective Accounting Standards

In May 2014, the FASB issued ASU 2014-09 “Revenue from Contract with Customers (Topic 606)” (“ASU 2014-09”). 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. ASU 2014-09 is currently effective for the Company beginning on January 1, 2018 with retrospective application to each prior reporting period presented. The Company is currently evaluating the potential impact of ASU 2014-09 on the Company’s financial statements.

In February 2016, the FASB issued ASU 2016-02 “Leases (Topic 842)” (“ASU 2016-02”). 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.” ASU 2016-02 will be effective for the Company on January 1, 2019 and will require transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The Company is currently evaluating the potential impact of ASU 2016-02 on the Company’s financial statements.

In March 2016, the FASB issued ASU 2016-09, “Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting” (“ASU 2016-09”). Under ASU 2016-09 all excess tax benefits and tax deficiencies related to share-based payment awards should be recognized as income tax expense or benefit in the income statement during the period in which they occur. Previously, such amounts were recorded in the pool of excess tax benefits included in additional paid-in capital, if such pool was available. Because excess tax benefits are no longer recognized in additional paid-in capital, the assumed proceeds from applying the treasury stock method when computing earnings per share should exclude the amount of excess tax benefits that would have previously been recognized in additional paid-in capital. Additionally, excess tax benefits should be classified along with other income tax cash flows as an operating activity rather than a financing activity, as was previously the case. ASU 2016-09 also provides that an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur. ASU 2016-09 changes the threshold to qualify for equity classification (rather than as a liability) to permit withholding up to the maximum statutory tax rates (rather than the minimum as was previously the case) in the applicable jurisdictions. ASU 2016-09 will be effective on January 1, 2017 and is not expected to have a significant impact on the Company’s financial statements.

In April 2016, the FASB issued ASU No. 2016-10, “Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing” (“ASU 2016-10”). ASU 2016-10 was issued to clarify ASC Topic 606, “Revenue from Contracts with Customers” related to (i) identifying performance obligations; and (ii) the licensing implementation guidance. The effective date and transition of ASU 2016-10 is the same as the effective date and transition of ASU 2014-09, “Revenue from Contracts with Customers (Topic 606),” as discussed above. The Company is currently evaluating the potential impact of ASU 2016-10 on the Company’s financial statements.

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments” (“ASU 2016-13”). 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. The amendments in ASU 2016-13 are effective for fiscal years beginning after December 31, 2019, and interim periods within those years for public business entities that are SEC filers. Early adoption is permitted for fiscal years, and interim periods within those years, beginning after December 15, 2018. The Company is currently evaluating the impact that the adoption of this standard will have on the Company's financial statements.

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ALLEGIANCE BANCSHARES, INC.
CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2016
(Unaudited)

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments" ("ASU 2016-15"). ASU 2016-15 provides guidance related to certain cash flow issues in order to reduce the current and potential future diversity in practice. ASU 2016-15 will be effective on January 1, 2018 and is not expected to have a significant impact on the Company's financial statements.

2. ACQUISITIONS

2015 Acquisition

Acquisition of F&M Bancshares - On January 1, 2015, the Company completed the acquisition of F&M Bancshares, Inc. ("F&M Bancshares") and its wholly-owned subsidiary Enterprise Bank ("Enterprise") headquartered in Houston, Texas. Enterprise operated nine banking locations, seven in Houston, Texas and two in Central Texas: one in Rosebud, Texas and one in Mart, Texas. During the first quarter of 2015, the Company consolidated two of the seven acquired Houston area locations due to the close proximity of these locations to the Company's existing banking locations. The Company acquired F&M Bancshares to further expand its Houston, Texas area market. During the first quarter of 2016, Allegiance completed the sale of the two Central Texas branch locations that were acquired as part of the F&M Bancshares acquisition. Allegiance sold \$18.2 million and \$26.6 million of loans and deposits, respectively, and recorded a gain of approximately \$2.1 million on the sale of these branches.

Pursuant to the merger agreement, the Company issued 2,338,520 shares of Company common stock for all outstanding shares of F&M Bancshares capital stock and paid \$642 thousand in cash for any fractional and out of state shares held by F&M Bancshares shareholders. The Company recognized initial goodwill of \$28.2 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. F&M Bancshares results of operations were included in the Company's results beginning January 1, 2015.

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ALLEGIANCE BANCSHARES, INC.
 CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
 SEPTEMBER 30, 2016
 (Unaudited)

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

Fair value of consideration paid:

Common shares issued (2,338,520 shares)	\$51,447
Preferred shares issued (11,550 shares)	11,550
Cash consideration	642
Total consideration paid	\$63,639

Fair value of assets acquired:

Cash and cash equivalents	\$107,128
Investment Securities	14,722
Loans, net	404,637
Premises and equipment	7,699
Core deposit intangibles	4,313
Other assets	15,896
Total assets acquired	\$554,395

Fair value of liabilities assumed:

Deposits	\$489,556
Subordinated debt	8,871
Other borrowed funds	18,000
Other liabilities	2,574
Total liabilities assumed	519,001
Fair value of net assets acquired	\$35,394
Goodwill resulting from acquisition	\$28,245

Subsequent to the acquisition, the Company paid off \$18.0 million of borrowed funds from F&M Bancshares shareholders by drawing on its borrowing facility with another financial institution. Additionally, the securities acquired from F&M Bancshares were sold subsequent to the acquisition with no income statement impact.

On July 15, 2015, the Company redeemed all of the outstanding shares of the Company's Series A and Series B preferred stock 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). The Company issued the shares of Series A and Series B preferred stock in connection with the F&M Bancshares acquisition, which had preferred stock pursuant to the U.S. Treasury's Troubled Asset Relief Program.

The Company incurred approximately \$941 thousand of pre-tax merger related expenses during the year ended December 31, 2015. The merger expenses are reflected on the Company's income statement for the applicable period and are reported primarily in the categories of salaries and benefits and professional fees.

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3. GOODWILL AND CORE DEPOSIT INTANGIBLE ASSETS

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

	Goodwill	Core Deposit Intangible Assets
	(Dollars in thousands)	
Balance as of January 1, 2015	\$11,144	\$ 1,747
Acquisition of F&M Bancshares	28,245	4,313
Amortization	—	(830)
Balance as of December 31, 2015	39,389	5,230
Sale of branch assets	—	(390)
Amortization	—	(590)
Balance as of September 30, 2016	\$39,389	\$ 4,250

Goodwill is recorded on the acquisition date of an entity. Management performs an evaluation annually, and more frequently if a triggering event occurs, of whether any impairment of the goodwill and other intangible assets has occurred. If any such impairment is determined, a write-down is recorded. As of September 30, 2016, there were no impairments recorded on goodwill and other intangible assets. During the first quarter of 2016, the Bank completed the sale of the two Central Texas branch locations acquired from F&M Bancshares in 2015 and wrote-down the core deposit intangible assets related to those locations.

The estimated aggregate future amortization expense for core deposit intangible assets remaining as of September 30, 2016 is as follows (dollars in thousands):

Remaining 2016	\$ 195
2017	781
2018	781
2019	781
2020	744
Thereafter	968
Total	\$4,250

4. SECURITIES

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

	September 30, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
U.S. Government and agency securities	\$5,871	\$ 474	\$ —	\$6,345
Municipal securities	222,299	6,722	(91)	228,930
Agency mortgage-backed pass-through securities	25,676	634	(69)	26,241
Corporate bonds	47,957	560	—	48,517
Total	\$301,803	\$ 8,390	\$ (160)	\$310,033

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	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
U.S. Government and agency securities	\$8,674	\$ 412	\$ —	\$9,086
Municipal securities	123,809	2,575	(35)	126,349
Agency mortgage-backed pass-through securities	29,511	397	(246)	29,662
Total	\$161,994	\$ 3,384	\$ (281)	\$165,097

The amortized cost and fair value of investment securities at September 30, 2016, 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	\$2,748	\$2,768
Due after one year through five years	68,334	69,234
Due after five years through ten years	80,158	82,241
Due after ten years	124,887	129,549
Subtotal	276,127	283,792
Agency mortgage-backed pass through securities	25,676	26,241
Total	\$301,803	\$310,033

As of September 30, 2016, the Company's management does not expect to sell any securities classified as available for sale with material unrealized losses; and the Company believes that the Company more likely than not 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 September 30, 2016, 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.

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

	September 30, 2016					
	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	\$—	\$ —	\$—	\$ —	\$—	\$ —
Municipal securities	20,343	(91)	—	—	20,343	(91)
Agency mortgage-backed pass-through securities	2,183	(5)	6,102	(64)	8,285	(69)

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Corporate bonds

Total

—	—	—	—	—	—
\$22,526	\$ (96)	\$6,102	\$ (64)	\$28,628	\$ (160)

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	December 31, 2015					
	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	\$—	\$ —	\$—	\$ —	\$—	\$ —
Municipal securities	6,867	(30)	298	(5)	7,165	(35)
Agency mortgage-backed pass-through securities	4,952	(36)	9,519	(210)	14,471	(246)
Total	\$11,819	\$ (66)	\$9,817	\$ (215)	\$21,636	\$ (281)

During the first quarter of 2015, the Company sold all securities acquired in the F&M Bancshares acquisition, resulting in gross proceeds of approximately \$15.0 million. No gains or losses were recognized. No securities were sold during the three and nine months ended September 30, 2016.

At September 30, 2016 and December 31, 2015, 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 consolidated stockholders' equity at such respective dates.

The carrying value of pledged securities was \$4.9 million at September 30, 2016. The securities are pledged to further collateralize letters of credit issued by the Bank but confirmed by another financial institution. The Company did not have pledged securities at December 31, 2015.

5. LOANS AND ALLOWANCE FOR LOAN LOSSES

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

	September 30, 2016	December 31, 2015
(Dollars in thousands)		
Loans held for sale ⁽¹⁾	\$—	\$27,887
Commercial and industrial	402,273	383,044
Mortgage warehouse	76,043	59,071
Real estate:		
Commercial real estate (including multi-family residential)	848,939	745,595
Commercial real estate construction and land development	167,936	154,646
1-4 family residential (including home equity)	228,651	205,200
Residential construction	93,923	93,848
Consumer and other	12,957	11,761
Total loans held for investment	1,830,722	1,653,165
Total loans	1,830,722	1,681,052
Allowance for loan losses	(17,185)	(13,098)
Loans, net	\$1,813,537	\$1,667,954

(1) Consisted of loans at two former F&M Bancshares locations acquired in 2015 and sold during the first quarter of 2016. At 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 multi-family residential) loans, \$2.3 million of 1-4 family

residential (including home equity) loans and \$803 thousand of consumer and other loans. Loans held for sale were carried at the lower of aggregate cost or fair value.

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Nonaccrual and Past Due Loans

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

	September 30, 2016					
	Loans Past Due and Still		Total Past Due Loans	Nonaccrual Loans	Current Loans	Total Loans
	Accruing					
	30-89 Days	90 or More Days				
	(Dollars in thousands)					
Commercial and industrial	\$712	\$ —	\$ 712	\$ 4,983	\$ 396,578	\$ 402,273
Mortgage warehouse	—	—	—	—	76,043	76,043
Real estate:						
Commercial real estate (including multi-family residential)	1,561	—	1,561	10,495	836,883	848,939
Commercial real estate construction and land development	99	—	99	—	167,837	167,936
1-4 family residential (including home equity)	315	—	315	11	228,325	228,651
Residential construction	856	—	856	—	93,067	93,923
Consumer and other	63	—	63	393	12,501	12,957
Total loans	\$3,606	\$ —	\$ 3,606	\$ 15,882	\$ 1,811,234	\$ 1,830,722
	December 31, 2015					
	Loans Past Due and Still		Total Past Due Loans	Nonaccrual Loans	Current Loans	Total Loans
	Accruing					
	30-89 Days	90 or More Days				
	(Dollars in thousands)					
Loans held for sale	\$539	\$ —	\$ 539	\$ 209	\$ 27,139	\$ 27,887
Commercial and industrial	1,474	—	1,474	2,664	378,906	383,044
Mortgage warehouse	—	—	—	—	59,071	59,071
Real estate:						
Commercial real estate (including multi-family residential)	1,866	—	1,866	2,006	741,723	745,595
Commercial real estate construction and land development	77	—	77	—	154,569	154,646
1-4 family residential (including home equity)	1,904	—	1,904	239	203,057	205,200
Residential construction	—	—	—	—	93,848	93,848
Consumer and other	36	—	36	66	11,659	11,761
Total loans held for investment	5,357	—	5,357	4,975	1,642,833	1,653,165
Total loans	\$5,896	\$ —	\$ 5,896	\$ 5,184	\$ 1,669,972	\$ 1,681,052

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Impaired Loans

Impaired loans by class of loans are set forth in the following tables. The average recorded investment presented in the table below is reported on a year-to-date basis.

	September 30, 2016		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in thousands)		
With no related allowance recorded:			
Commercial and industrial	\$6,196	\$ 6,949	\$ —
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	12,607	12,693	—
Commercial real estate construction and land development	—	—	—
1-4 family residential (including home equity)	798	798	—
Residential construction	—	—	—
Consumer and other	8	8	—
Total	19,609	20,448	—
With an allowance recorded:			
Commercial and industrial	2,497	2,497	1,118
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	240	240	24
Commercial real estate construction and land development	—	—	—
1-4 family residential (including home equity)	—	—	—
Residential construction	—	—	—
Consumer and other	45	45	16
Total	2,782	2,782	1,158
Total:			
Commercial and industrial	8,693	9,446	1,118
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	12,847	12,933	24
Commercial real estate construction and land development	—	—	—
1-4 family residential (including home equity)	798	798	—
Residential construction	—	—	—
Consumer and other	53	53	16
	\$22,391	\$ 23,230	\$ 1,158

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	Year Ended December 31, 2015		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in thousands)		
With no related allowance recorded:			
Commercial and industrial	\$3,842	\$ 4,216	\$ —
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	4,700	4,700	—
Commercial real estate construction and land development	—	—	—
1-4 family residential (including home equity)	239	239	—
Residential construction	—	—	—
Consumer and other	82	97	—
Total	8,863	9,252	—
With an allowance recorded:			
Commercial and industrial	1,573	1,573	670
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	1,146	1,146	180
Commercial real estate construction and land development	—	—	—
1-4 family residential (including home equity)	—	—	—
Residential construction	—	—	—
Consumer and other	19	19	9
Total	2,738	2,738	859
Total:			
Commercial and industrial	5,415	5,789	670
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	5,846	5,846	180
Commercial real estate construction and land development	—	—	—
1-4 family residential (including home equity)	239	239	—
Residential construction	—	—	—
Consumer and other	101	116	9
	\$11,601	\$ 11,990	\$ 859

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The following table presents average impaired loans and interest recognized on impaired loans for the three and nine months ended September 30, 2016 and 2015:

	Three Months Ended September 30,			
	2016		2015	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
Commercial and industrial	\$7,461	\$ 211	\$4,021	\$ 57
Mortgage warehouse	—	—	—	—
Real estate:				
Commercial real estate (including multi-family residential)	12,486	159	2,022	14
Commercial real estate construction and land development	—	—	—	—
1-4 family residential (including home equity)	524	16	380	2
Residential construction	—	—	—	—
Consumer and other	50	1	127	1
Total	20,521	387	6,550	74
	Nine Months Ended September 30,			
	2016		2015	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
Commercial and industrial	\$8,963	\$ 374	\$4,285	\$ 155
Mortgage warehouse	—	—	—	—
Real estate:				
Commercial real estate (including multi-family residential)	13,373	381	1,867	86
Commercial real estate construction and land development	—	—	—	—
1-4 family residential (including home equity)	814	24	382	12
Residential construction	—	—	—	—
Consumer and other	61	3	132	7
Total	23,211	782	6,666	260

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:

Pass—Loans classified as pass are loans with low to average risk and not otherwise classified as watch, special mention, substandard or doubtful. In addition, the guaranteed portion of SBA loans are considered pass risk rated loans.

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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 classified loans 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.

Based on the most recent analysis performed, the risk category of loans by class of loan at September 30, 2016 is as follows:

	Pass	Watch	Special Mention	Substandard	Doubtful	Total
	(Dollars in thousands)					
Commercial and industrial	\$372,039	\$5,878	\$5,381	\$ 18,975	\$	—\$402,273
Mortgage warehouse	76,043	—	—	—	—	76,043
Real estate:						
Commercial real estate (including multi-family residential)	787,213	16,201	7,103	38,422	—	848,939
Commercial real estate construction and land development	159,143	8,288	—	505	—	167,936
1-4 family residential (including home equity)	224,325	298	1,848	2,180	—	228,651
Residential construction	93,076	—	415	432	—	93,923
Consumer and other	12,423	397	—	137	—	12,957
Total loans	\$1,724,262	\$31,062	\$14,747	\$ 60,651	\$	—\$1,830,722

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The following table presents the risk category of loans by class of loan at December 31, 2015:

	Pass	Watch	Special Mention	Substandard	Doubtful	Total
	(Dollars in thousands)					
Loans held for sale	\$26,570	\$477	\$ 19	\$ 821	\$	—\$27,887
Commercial and industrial	366,479	8,094	1,253	7,218	—	383,044
Mortgage warehouse	59,071	—	—	—	—	59,071
Real estate:						
Commercial real estate (including multi-family residential)	721,781	7,186	790	15,838	—	745,595
Commercial real estate construction and land development	152,380	1,846	—	420	—	154,646
1-4 family residential (including home equity)	200,262	2,385	390	2,163	—	205,200
Residential construction	93,848	—	—	—	—	93,848
Consumer and other	11,522	155	18	66	—	11,761
Total loans held for investment	1,605,343	19,666	2,451	25,705	—	1,653,165
Total loans	\$1,631,913	\$20,143	\$ 2,470	\$ 26,526	\$	—\$1,681,052

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Allowance for Loan Losses

The following table presents the activity in the allowance for loan losses by portfolio type for the three and nine months ended September 30, 2016 and September 30, 2015:

	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:								
Three Months Ended								
Balance June 30, 2016	\$4,105	\$ —	—\$ 6,846	\$ 1,368	\$ 1,642	\$ 887	\$ 69	\$14,917
Provision for loan losses	781	—	1,563	(76)	101	(159)	4	2,214
Charge-offs	(8)	—	—	—	—	—	(4)	(12)
Recoveries	22	—	43	—	—	—	1	66
Net charge-offs	14	—	43	—	—	—	(3)	54
Balance September 30, 2016	\$4,900	\$ —	—\$ 8,452	\$ 1,292	\$ 1,743	\$ 728	\$ 70	\$17,185
Nine Months Ended								
Balance January 1, 2016	\$3,644	\$ —	—\$ 5,914	\$ 1,221	\$ 1,432	\$ 820	\$ 67	\$13,098
Provision for loan losses	1,640	—	2,624	71	301	(92)	25	4,569
Charge-offs	(451)	—	(129)	—	—	—	(26)	(606)
Recoveries	67	—	43	—	10	—	4	124
Net charge-offs	(384)	—	(86)	—	10	—	(22)	(482)
Balance September 30, 2016	\$4,900	\$ —	—\$ 8,452	\$ 1,292	\$ 1,743	\$ 728	\$ 70	\$17,185

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	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:								
Three Months Ended								
Balance June 30, 2015	\$2,905	\$ —	—\$ 4,533	\$ 842	\$ 1,255	\$ 710	\$ 67	\$10,312
Provision for loan losses	820	—	434	173	68	25	10	1,530
Charge-offs	(641)	—	—	—	—	—	(8)	(649)
Recoveries	7	—	—	—	—	2	2	11
Net charge-offs	(634)	—	—	—	—	2	(6)	(638)
Balance September 30, 2015	\$3,091	\$ —	—\$ 4,967	\$ 1,015	\$ 1,323	\$ 737	\$ 71	\$11,204
Nine Months Ended								
Balance January 1, 2015	\$2,334	\$ —	—\$ 3,799	\$ 578	\$ 1,008	\$ 475	\$ 52	\$8,246
Provision for loan losses	1,434	—	1,168	437	315	238	41	3,633
Charge-offs	(723)	—	—	—	—	—	(26)	(749)
Recoveries	46	—	—	—	—	24	4	74
Net charge-offs	(677)	—	—	—	—	24	(22)	(675)
Balance September 30, 2015	\$3,091	\$ —	—\$ 4,967	\$ 1,015	\$ 1,323	\$ 737	\$ 71	\$11,204

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The following table presents the balance in the allowance for loan losses by portfolio type based on the impairment method as of September 30, 2016 and December 31, 2015:

	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:								
September 30, 2016								
Individually evaluated for impairment	\$ 1,118	\$ —	—\$ 24	\$ —	\$ —	\$ —	\$ 16	\$ 1,158
Collectively evaluated for impairment	3,782	—	8,428	1,292	1,743	728	54	16,027
Total allowance for loan losses	\$ 4,900	\$ —	—\$ 8,452	\$ 1,292	\$ 1,743	\$ 728	\$ 70	\$ 17,185

December 31, 2015								
Individually evaluated for impairment	\$ 670	\$ —	—\$ 180	\$ —	\$ —	\$ —	\$ 9	\$ 859
Collectively evaluated for impairment	2,974	—	5,734	1,221	1,432	820	58	12,239
Total allowance for loan losses	\$ 3,644	\$ —	—\$ 5,914	\$ 1,221	\$ 1,432	\$ 820	\$ 67	\$ 13,098

The following table presents the recorded investment in loans held for investment by portfolio type based on the impairment method as of September 30, 2016 and December 31, 2015:

	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:								
September 30, 2016								
Individually evaluated for impairment	\$ 8,693	\$ —	\$ 12,847	\$ —	\$ 798	\$ —	\$ 53	\$ 22,391
Collectively evaluated for impairment	393,580	76,043	836,092	167,936	227,853	93,923	12,904	1,808,331
Total loans evaluated for impairment	\$ 402,273	\$ 76,043	\$ 848,939	\$ 167,936	\$ 228,651	\$ 93,923	\$ 12,957	\$ 1,830,722

December 31, 2015

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Individually evaluated for impairment	\$5,415	\$—	\$ 5,846	\$—	\$239	\$—	\$ 101	\$11,601
Collectively evaluated for impairment	377,629	59,071	739,749	154,646	204,961	93,848	11,660	1,641,564
Total loans evaluated for impairment	\$383,044	\$ 59,071	\$ 745,595	\$ 154,646	\$205,200	\$ 93,848	\$ 11,761	\$1,653,165

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Troubled Debt Restructurings

Following is a summary of loans modified under troubled debt restructurings during the nine months ended September 30, 2016 and September 30, 2015:

	As of September 30,		2015	
	2016			
	Pre-Modification Number of Contracts Recorded Investment	Post-Modification of Outstanding Recorded Investment	Pre-Modification Number of Contracts Recorded Investment	Post-Modification of Outstanding Recorded Investment
	(Dollars in thousands)			
Troubled Debt Restructurings				
Commercial and industrial	16	\$ 3,803	\$ 3,803	5 \$ 2,921 \$ 2,915
Mortgage warehouse	—	—	—	—
Real estate:				
Commercial real estate (including multi-family residential)	7	6,882	6,882	— —
Commercial real estate construction and land development	—	—	—	—
1-4 family residential (including home equity)	—	—	—	—
Residential construction	—	—	—	—
Consumer and other	1	7	7	1 17 17
Total	24	\$ 10,692	\$ 10,692	6 \$ 2,938 \$ 2,932

As of September 30, 2016 and December 31, 2015, the Company had a recorded investment in troubled debt restructurings of \$12.8 million and \$3.1 million, respectively. The Company allocated \$920 thousand and \$681 thousand of specific reserves for troubled debt restructurings at September 30, 2016 and December 31, 2015, respectively, and did not commit to lend additional amounts on these loans. As of September 30, 2016 and September 30, 2015, there were no loans modified under troubled debt restructurings during the previous twelve month period that subsequently defaulted during the nine months ended September 30, 2016 and September 30, 2015, respectively. The modifications primarily related to extending the amortization periods of the loans. Default is determined at 90 or more days past due.

6. 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 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

The Company groups financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

• **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.

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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 September 30, 2016				
	Carrying Amount	Estimated Fair Value			Total
		Level 1	Level 2	Level 3	
Financial assets	(Dollars in thousands)				
Cash and cash equivalents	\$225,082	\$225,082	\$—	\$	—\$225,082
Available for sale securities	310,033	—	310,033	—	310,033
Loans held for investment, net of allowance	1,813,537	—	—	1,818,526	1,818,526
Accrued interest receivable	6,962	1	1,981	4,980	6,962
Financial liabilities					
Total deposits	\$1,900,879	\$—	\$1,904,065	—	\$1,904,065
Accrued interest payable	259	—	259	—	259
Short-term borrowings	61,000	—	61,000	—	61,000
Other borrowed funds	200,569	—	199,699	—	199,699
Subordinated debentures	9,169	—	9,169	—	9,169
	As of December 31, 2015				
	Carrying Amount	Estimated Fair Value			Total
		Level 1	Level 2	Level 3	
Financial assets	(Dollars in thousands)				
Cash and cash equivalents	\$148,431	\$148,431	\$—	\$	—\$148,431
Available for sale securities	165,097	—	165,097	—	165,097
Loans held for sale	27,887	—	—	27,887	27,887
Loans held for investment, net of allowance	1,640,067	—	—	1,641,862	1,641,862
Accrued interest receivable	6,518	—	1,780	4,738	6,518
Financial liabilities					
Total deposits	\$1,759,133	\$—	\$1,759,728	\$	—\$1,759,728
Accrued interest payable	124	—	124	—	124
Short-term borrowings	50,000	—	50,000	—	50,000
Other borrowed funds	569	—	569	—	569
Subordinated debentures	9,089	—	9,089	—	9,089

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The fair value estimates presented above are based on pertinent information available to management as of the dates indicated. The methods used to determine fair value are described in our audited financial statements which are presented in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

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

	As of September 30, 2016		
	Level 1	Level 2	Level 3 Total
	(Dollars in thousands)		
Available for sale securities:			
U.S. Government and agency securities	\$—	\$6,345	\$—
Municipal securities	228,930	—	—
Agency mortgage-backed pass-through securities	26,241	—	—
Corporate bonds	48,517	—	—
	\$—	\$310,033	\$—

	As of December 31, 2015		
	Level 1	Level 2	Level 3 Total
	(Dollars in thousands)		
Available for sale securities:			
U.S. Government and agency securities	\$—	\$9,086	\$—
Municipal securities	126,349	—	—
Agency mortgage-backed pass-through securities	29,662	—	—
	\$—	\$165,097	\$—

There were no liabilities measured at fair value on a recurring basis as of September 30, 2016 or December 31, 2015. There were no transfers between levels during the nine months ended September 30, 2016 or September 30, 2015. 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 September 30, 2016	
	Level 1	Level 2 Level 3
	(Dollars in thousands)	
Impaired loans:		
Commercial and industrial	\$—	\$1,379
Commercial real estate (including multi-family residential)	—	216
Consumer and other	—	29
Other real estate owned	—	1,138
	\$—	\$2,762

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	As of December 31, 2015	
	Level 2	Level 3
	(Dollars in thousands)	
Impaired loans:		
Commercial and industrial	\$—	—\$ 903
Commercial real estate (including multi-family residential)	—	966
Consumer and other	—	10
	\$—	—\$ 1,879

Impaired Loans

During the nine months ended September 30, 2016 and 2015, certain impaired loans were reevaluated and reported at fair value through a specific allocation of the allowance for loan losses. At September 30, 2016, the total reported fair value of impaired loans of \$1.6 million based on collateral valuations utilizing Level 3 valuation inputs had a carrying value of \$2.8 million that was reduced by specific allowance allocations totaling \$1.2 million. At September 30, 2015, the total reported fair value of impaired loans of \$2.1 million based on collateral valuations utilizing Level 3 valuation inputs had a carrying value of \$2.8 million that was reduced by specific allowance allocations totaling \$700 thousand.

Other Real Estate Owned

At September 30, 2016, the balance of other real estate owned included \$1.1 million of foreclosed commercial real estate properties recorded as a result of obtaining physical possession of the property. At September 30, 2016, the recorded investment of commercial real estate land loans secured by non-residential real estate properties for which formal foreclosure proceeds are in process is \$160 thousand. The Company did not have any other real estate owned at December 31, 2015.

7. DEPOSITS

Time deposits that meet or exceed the Federal Deposit Insurance Corporation Insurance limit of \$250 thousand at September 30, 2016 and December 31, 2015 were \$194.5 million and \$164.7 million, respectively.

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

Within one year	\$423,786
After one but within two years	122,828
After two but within three years	84,464
After three but within four years	18,305
After four but within five years	30,728
Total	\$680,111

8. BORROWINGS

The Company has an available line of credit with the Federal Home Loan Bank (“FHLB”) of Dallas, which allows the Company to borrow on a collateralized basis. FHLB advances are short-term borrowings and are used to manage liquidity as needed. Maturing advances are replaced by drawing on available cash, making additional borrowings or through increased customer deposits. At September 30, 2016, the Company had a total borrowing capacity of \$652.7 million, of which \$359.4 million was available and \$293.4 million was outstanding. Short-term FHLB advances of \$61.0 million were outstanding at September 30, 2016, at a weighted average interest rate of 0.56%. Long-term FHLB borrowings of \$200.0 million were outstanding at September 30, 2016, at a weighted average interest rate of 0.37%. Letters of credit were \$32.4 million at September 30, 2016, \$25.0 million will expire in October 2016, \$3.0 million will expire in February 2017 and \$4.3 million will expire in August 2017.

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In 2015, the Company borrowed an additional \$18.0 million under a revolving credit agreement with another financial institution. The borrowing under this revolving credit agreement matures in December 2021. The Company used the funds borrowed in 2015 under this revolving credit agreement to repay amounts owed by F&M Bancshares under a previous borrowing agreement with another financial institution entered into during 2013 in conjunction with the purchase of Independence Bank. In October 2015, the Company paid down \$27.5 million under this revolving credit agreement with a portion of the proceeds from the Company's initial public offering. The revolving credit agreement requires the Company to meet certain restrictive covenants. At September 30, 2016, the Company believes it is in compliance with all such covenants and had not been made aware of any noncompliance by the lender. The interest rate on the outstanding debt under the revolving credit agreement is the Prime rate minus 25 basis points, or 3.25%, at September 30, 2016, and is paid quarterly. Scheduled principal maturities are as follows (dollars in thousands):

Remaining 2016	\$—
2017	—
2018	—
2019	—
2020	—
2021 and thereafter	569
Total	\$569

9. 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. Each of these 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 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 such trust, provided such trust has funds available for such obligations.

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.

The Company assumed the junior subordinated debentures with an aggregate original principal amount of \$11.3 million and a current fair value at September 30, 2016 of \$9.2 million. 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. At September 30, 2016, the Company had \$11.3 million outstanding in junior subordinated debentures issued to the Company's unconsolidated subsidiary trusts. The junior subordinated debentures are included in Tier 1 capital under current regulatory guidelines and interpretations.

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A summary of pertinent information related to the Company's issues of junior subordinated debentures outstanding at September 30, 2016 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⁾
(Dollars in thousands)					
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 September 30, 2016 was 0.8497%.

(2) All debentures are currently callable.

10. INCOME TAXES

The amount of the Company's federal and state income tax expense is influenced by the amount of the Company's pre-tax income, the amount of tax-exempt income and the amount of other nondeductible items. For the three and nine months ended September 30, 2016, income tax expense was \$2.1 million and \$7.5 million, respectively, compared with \$2.0 million and \$5.8 million, respectively, for the three and nine months ended September 30, 2015, respectively. The increase in income tax expense year over year was primarily attributable to higher pre-tax earnings. The effective income tax rate for the three and nine months ended September 30, 2016 was 27.8% and 30.6%, respectively, compared to 31.7% and 33.4%, respectively, for the three and nine months ended September 30, 2015. The effective tax rate decreased for the three and nine months ended September 30, 2016 compared to the same periods in 2015 primarily due to the increase in tax free income from the purchase of additional municipal securities and the cashless exercise of stock options by employees during the third quarter of 2016.

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 has not recorded any interest and penalties in its income statement for the three and nine months ended September 30, 2016 and September 30, 2015. The Company is no longer subject to examination by the U.S. Federal Tax Jurisdiction for the years prior to 2012.

11. STOCK BASED COMPENSATION

During 2008, the Company's Board of Directors and shareholders approved the 2008 Stock Awards and Incentive Plan (the "Plan") that permits certain key employees to purchase shares of the Company's stock. The Plan was amended in 2015 as the shareholders authorized a maximum aggregate number of shares of stock to be issued of 1,460,000, any or all of which may be issued through incentive stock options. 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 \$370 thousand and \$1.1 million for the three and nine months ended September 30, 2016, respectively, and \$310 thousand and \$951 thousand for the three and nine months ended September 30, 2015, respectively.

Stock Option Plan

Options to purchase a total of 1,215,881 shares of Company stock have been granted as of September 30, 2016. Under the stock option plan, options are exercisable up to 10 years from the date of the grant and are fully vested 4 years

after the date of grant, unless otherwise provided by the Board of Directors.

The fair value of stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model.

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A summary of the activity in the stock option plan during the nine months ended September 30, 2016 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, 2016	969	\$ 17.45	6.62	\$ 6,006
Options granted	82	21.74		
Options exercised	(61)	13.54		
Options forfeited	(22)	21.54		
Options outstanding, September 30, 2016	968	\$ 17.96	6.35	\$ 8,757
Options vested and exercisable, September 30, 2016	564	\$ 15.47	4.91	\$ 6,501

Share Award Plan

During 2016, the Company issued 14,651 shares of restricted stock. The restricted stock shares will vest over a period of 4 years but are considered outstanding at the date of issuance. The Company accounts for restricted stock grants by recording the fair value of the grant as compensation expense over the vesting period.

A summary of the activity of the nonvested shares of restricted stock during the nine months ended September 30, 2016 is as follows:

	Number of Shares (Shares in thousands)	Weighted Average Grant Date Fair Value
Nonvested share awards outstanding, January 1, 2016	18	\$ 19.68
Share awards granted	14	17.23
Share awards vested	(7)	19.06
Unvested share awards forfeited	—	—
Nonvested share awards outstanding, September 30, 2016	25	\$ 18.38

12. 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.

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

	September 30, 2016		December 31, 2015	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
	(Dollars in thousands)			
Commitments to extend credit	\$344,904	\$190,292	\$252,662	\$222,198
Standby letters of credit	8,299	125	9,456	—
Total	\$353,203	\$190,417	\$262,118	\$222,198

Commitments to make loans are generally made for an approval period of 120 days or fewer. As of September 30, 2016, the funded fixed rate loan commitments have interest rates ranging from 1.60% to 7.50% with a weighted average maturity and rate of 2.46 years and 5.11%, respectively.

Litigation

From time to time, the Company is subject to claims and litigation arising in the ordinary course of business. In the opinion of management, the Company is not party to any legal proceedings the resolution of which it believes would have a material adverse effect on the Company's business, prospects, financial condition, liquidity, results of operation, cash flows or capital levels. However, one or more unfavorable outcomes in any claim or litigation against the Company could have a material adverse effect for the period in which such claim or litigation is resolved. In addition, regardless of their merits or their ultimate outcomes, such matters are costly, divert management's attention and may materially adversely affect the Company's reputation, even if resolved in its favor. The Company intends to defend itself vigorously against any future claims or litigation.

13. REGULATORY CAPITAL MATTERS

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Capital adequacy guidelines include prompt corrective action regulations and 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. Any institution that fails to meet its minimum capital requirements is subject to actions by regulators that could have a direct material effect on the Company's financial statements. The Company is subject to the Basel III regulatory capital framework (the "Basel III Rules"). The 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 fully phased in by January 1, 2019. Starting in January 2016, the implementation of the capital conservation buffer was effective for the Company starting at the 0.625% level and increasing 0.625% each year thereafter, until it reaches 2.5% on January 1, 2019. The capital conservation buffer is designed to absorb losses during periods of economic stress and requires increased capital levels for the purpose of capital distributions and other payments. Failure to meet the full amount of the buffer will result in restrictions on the Company's ability to make capital distributions, including dividend payments and stock repurchases and to pay discretionary bonuses to executive officers. Management believes as of September 30, 2016 and December 31, 2015 the Company and the Bank met all capital adequacy requirements to which they were then 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.

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The following is a summary of the Company's and the Bank's actual and required capital ratios at September 30, 2016 and December 31, 2015:

	Actual		For Capital Adequacy Purposes		To Be Categorized As Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in thousands)						
ALLEGIANCE BANCSHARES, INC.						
(Consolidated)						
As of September 30, 2016						
Total Capital (to Risk Weighted Assets)	\$260,160	12.68%	\$164,120	8.00%	N/A	N/A
Common Equity Tier 1 Capital (to Risk Weighted Assets)	233,806	11.40%	92,317	4.50%	N/A	N/A
Tier I Capital (to Risk Weighted Assets)	242,975	11.84%	123,090	6.00%	N/A	N/A
Tier I Capital (to Average Tangible Assets)	242,975	10.25%	94,848	4.00%	N/A	N/A
As of December 31, 2015						
Total Capital (to Risk Weighted Assets)	\$237,178	12.92%	\$146,811	8.00%	N/A	N/A
Common Equity Tier 1 Capital (to Risk Weighted Assets)	214,991	11.72%	82,581	4.50%	N/A	N/A
Tier I Capital (to Risk Weighted Assets)	224,080	12.21%	110,109	6.00%	N/A	N/A
Tier I Capital (to Average Tangible Assets)	224,080	11.02%	81,315	4.00%	N/A	N/A
ALLEGIANCE BANK						
As of September 30, 2016						
Total Capital (to Risk Weighted Assets)	\$240,788	11.74%	\$164,066	8.00%	\$205,082	10.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	223,603	10.90%	92,287	4.50%	133,304	6.50%
Tier I Capital (to Risk Weighted Assets)	223,603	10.90%	123,049	6.00%	164,066	8.00%
Tier I Capital (to Average Tangible Assets)	223,603	9.43%	94,823	4.00%	118,529	5.00%
As of December 31, 2015						
Total Capital (to Risk Weighted Assets)	\$219,487	11.96%	\$146,779	8.00%	\$183,474	10.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	206,389	11.25%	82,563	4.50%	119,258	6.50%
Tier I Capital (to Risk Weighted Assets)	206,389	11.25%	110,084	6.00%	146,779	8.00%
Tier I Capital (to Average Tangible Assets)	206,389	10.16%	81,291	4.00%	101,614	5.00%

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14. 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 and are included in basic and diluted weighted average common shares outstanding.

	Three Months Ended September 30, 2016		2015		Nine Months Ended September 30, 2016		2015	
	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount
Net income attributable to common stockholders	\$5,471		\$4,047		\$17,080		\$11,015	
Basic:								
Weighted average common shares outstanding	12,882	\$ 0.42	9,823	\$ 0.41	12,860	\$ 1.33	9,823	\$ 1.12
Diluted:								
Add incremental shares for:								
Dilutive effect of stock option exercises	226		180		178		178	
Total	13,108	\$ 0.42	10,003	\$ 0.40	13,038	\$ 1.31	10,001	\$ 1.10

Stock options for 318 thousand shares were not considered in computing diluted earnings per common share as of September 30, 2015 because they were antidilutive. There were no antidilutive shares as of September 30, 2016.

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

Except where the context otherwise requires or where otherwise indicated, in this Quarterly Report on Form 10-Q the terms "we," "us," "our," "Company" and "our business" refer to Allegiance Bancshares, Inc. and our wholly-owned banking subsidiary, Allegiance Bank, a Texas banking association, and the terms "Allegiance Bank" or the "Bank" refer to Allegiance Bank. In this Quarterly Report on Form 10-Q, we refer to the Houston-The Woodlands-Sugar Land metropolitan statistical area as the "Houston metropolitan area."

Cautionary Notice Regarding Forward-Looking Statements

Statements and financial discussion and analysis contained in this Quarterly Report on Form 10-Q 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 verbs 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 metropolitan area, 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 metropolitan area;

- 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;

- 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;

- potential impairment on the goodwill we have recorded or may record in connection with business 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;

- 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;

- changes in market interest rates that affect the pricing of our loans and deposits and our net interest income;

- 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;
• our ability to maintain an effective system of disclosure controls and procedures and internal controls over financial reporting;

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- 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;
- risks associated with data processing system failures and errors;
- 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; 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 headings "Risk Factors", "Quantitative and Qualitative Disclosures about Market Risk" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2015 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 revenues 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 stockholders' equity, also fund interest-earning assets, net interest margin includes the benefit of these noninterest-bearing sources. 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 metropolitan area, 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 other 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.

Our objective is to grow and strengthen our community banking franchise by deploying our super-community banking strategy and pursuing select strategic acquisitions in the Houston metropolitan area. We are positioning the Bank to be a leading provider of personalized commercial banking services by emphasizing the strength and capabilities of local bank office management and providing superior customer service. We have made the strategic decision to focus on the Houston

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metropolitan area because of our deep roots and experience operating through a variety of economic cycles in this large and vibrant market.

Super-community banking strategy. Our super-community banking strategy emphasizes community involvement by its directors, officers and employees, which allows us to be responsive in developing our products and services. Our approach produces a clear competitive advantage by delivering an extraordinary customer experience and fostering a culture dedicated to achieving both superior external and internal service levels. Greater efficiency results from our focus on serving a select, but significant, portion of the overall banking market, and on the operational leverage that results from a market share driven by geographic concentration. We focus on establishing personal relationships with customers through superior service, which is accomplished in part by empowering our personnel to make certain business decisions at a local level in order to respond quickly to customers' needs. We emphasize lending to and banking with small to medium-sized businesses, for which we believe loans can be priced on terms that are more attractive to us than would be achieved by lending to larger businesses. We operate full-service decentralized branches and employ lenders with strong underwriting credentials who are authorized to make loan and underwriting decisions up to prescribed limits at the branch level. We support branch operations with a centralized credit approval process for larger credit relationships, loan operations, information technology, core data processing, accounting, finance, treasury and treasury management support, deposit operations and executive and board oversight.

We plan to continue to emphasize the super-community banking strategy to organically grow our presence in the Houston metropolitan area through:

- increasing the productivity of existing bankers, as measured by loans, deposits and fee income per banker, while enhancing profitability by leveraging our existing operating platform;
- focusing on local and individualized decision-making, allowing us to provide customers with rapid decisions on loan requests, which we believe allows us to effectively compete with larger financial institutions;
- identifying and hiring additional seasoned bankers in our existing and target markets in the Houston metropolitan area who will thrive utilizing our super-community banking model, and opening additional branches where we are able to attract seasoned bankers; and
- developing new products designed to serve the increasingly diversified Houston economy, while preserving our strong culture of risk management.

Select strategic acquisitions. We intend to continue to expand our market position in the Houston metropolitan area through organic growth, including with the establishment of de novo branch locations, and through a disciplined acquisition strategy. We focus on like-minded community banks with similar lending strategies to our own when evaluating acquisition opportunities. We believe that our management's experience in assessing, executing and integrating target institutions will allow us to capitalize on acquisition opportunities. On January 1, 2015, we completed the acquisition of F&M Bancshares Inc. ("F&M Bancshares") and its subsidiary bank, Enterprise Bank ("Enterprise"). The results for the three and nine months ended September 30, 2016 and September 30, 2015 reflect the combined entity.

Recent Developments

On January 31, 2016, the Bank completed the sale of its two Central Texas branch locations that were acquired as part of the F&M Bancshares acquisition, to Incommons Bank, N.A., a national banking association headquartered in Mexia, Texas. Under the terms of the purchase and assumption agreement, Incommons Bank, N.A. acquired certain assets and assumed certain liabilities associated with the Mart branch location at 714 Texas Avenue in Mart, Texas and the Rosebud branch location at 339 Main Street in Rosebud, Texas. Allegiance sold \$18.2 million and \$26.6 million of loans and deposits, respectively, and recorded a gain of approximately \$2.1 million on the sale of these branches.

Critical Accounting Policies

Our accounting policies are integral to understanding our results of operations. Our accounting policies are described in detail in Note 1 to our Annual Report on Form 10-K for the year ended December 31, 2015. We believe that of our accounting policies, the following may involve a higher degree of judgment and complexity:

Securities

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

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of stockholders' equity until realized. Securities within the available for sale portfolio may be used as part of our 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 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 basis less the OTTI recognized in earnings becomes the new amortized cost basis of the security.

Nonperforming and Past Due Loans

Loans are placed on nonaccrual status when payment in full of principal or interest is not expected or upon which principal or interest has been in default for a period of 90 days or more unless the asset is both well secured and in the process of collection. 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. Events requiring charge-offs occur when a shortfall is identified between the recorded investment in the loan and the underlying value of the collateral.

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-off 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 earnings 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. 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.

Our allowance for loan losses, both in dollars and as a percentage of total loans, may not be comparable to other similar sized institutions due to the impact of acquisition accounting. As part of acquisition accounting, acquired loans are initially recognized at fair value with no corresponding allowance for loan losses. Initial fair value of the loans includes consideration of expected credit losses.

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Loans for which the terms have been modified, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and therefore classified as impaired. Subsequent to identification as a troubled debt restructuring, such loans are then evaluated for impairment on an individual basis whereby we determine the amount of reserve in accordance with the accounting policy for the impaired loans as part of our allowance for loan losses calculation. 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.

Accounting for Acquired Loans

At the time of an acquisition, we evaluate loans to determine if they are purchase credit impaired loans. Purchased credit impaired loans are those acquired loans with evidence of credit deterioration for which it was probable at acquisition that we would be unable to collect all contractual payments. We make this determination by considering past due and/or nonaccrual status, prior designation of a troubled debt restructuring, or other factors that may suggest we will not be able to collect all contractual payments. Purchased credit impaired loans are initially recorded at fair value with the difference between fair value and estimated future cash flows accreted over the expected cash flow period as income only to the extent we can reasonably estimate the timing and amount of future cash flows. In this case, these loans would be classified as accruing. In the event we are unable to reasonably estimate timing and amount of future cash flows, the loan is classified as non-accrual. An acquired loan previously classified by the seller as a troubled debt restructuring is no longer classified as such at the date of acquisition. Past due status is reported based on contractual payment status.

Our purchase credit impaired loans have generally been de minimis and comprised 0.1% of our loan portfolio at September 30, 2016. Historically, purchased credit impaired loans have been placed on nonaccrual status and reported as such until we were able to reasonably estimate the timing and amount of future expected cash flows. Income associated with purchased credit impaired loans for the three and nine months ended September 30, 2016 and prior periods has been immaterial.

All loans not otherwise classified as purchase credit impaired are recorded at fair value with the discount to contractual value accreted over the life of the loan. When determining the allowance for loan losses on acquired loans, we bifurcate the allowance between legacy loans and acquired loans. Loans remain designated as acquired until either (i) loan is renewed or (ii) loan is substantially modified whereby modification results in a new loan. When determining the allowance on acquired loans, the Company estimates principal losses as compared to the Company's recorded investment, with the recorded investment being net of any unaccreted discounts from the acquisition. At September 30, 2016, we had \$205.2 million in acquired loans that have not been renewed or substantially modified, which is net of an unaccreted discount of \$1.1 million or 0.54%.

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 assessed annually for impairment or when events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Goodwill acquired in a purchase business combination that is determined to have an indefinite useful life, is not amortized, but tested for impairment. We perform our annual impairment test on October 1st. Goodwill is the only intangible asset with an indefinite life on our balance sheet.

Adoption of New Accounting Standards

On January 1, 2016, we adopted ASU 2015-16, "Business Combinations (Topic 805) – Simplifying the Accounting for Measurement-Period Adjustments." ASU 2015-16 requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The acquirer must record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. Additionally, the entity is required to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in

current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. The adoption of ASU 2015-16 did not have a significant impact on our financial statements.

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Newly Issued But Not Yet Effective Accounting Standards

In May 2014, the FASB issued ASU 2014-09 “Revenue from Contract with Customers (Topic 606)” (“ASU 2014-09”). 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. ASU 2014-09 is currently effective for us beginning on January 1, 2018 with retrospective application to each prior reporting period presented. We are currently evaluating the potential impact of ASU 2014-09 on our financial statements.

In February 2016, the FASB issued ASU 2016-02 “Leases (Topic 842)” (“ASU 2016-02”). 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.” ASU 2016-02 will be effective for us on January 1, 2019 and will require transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. We are currently evaluating the potential impact of ASU 2016-02 on our financial statements.

In March 2016, the FASB issued ASU 2016-09, “Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting” (“ASU 2016-09”). Under ASU 2016-09 all excess tax benefits and tax deficiencies related to share-based payment awards should be recognized as income tax expense or benefit in the income statement during the period in which they occur. Previously, such amounts were recorded in the pool of excess tax benefits included in additional paid-in capital, if such pool was available. Because excess tax benefits are no longer recognized in additional paid-in capital, the assumed proceeds from applying the treasury stock method when computing earnings per share should exclude the amount of excess tax benefits that would have previously been recognized in additional paid-in capital. Additionally, excess tax benefits should be classified along with other income tax cash flows as an operating activity rather than a financing activity, as was previously the case. ASU 2016-09 also provides that an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur. ASU 2016-09 changes the threshold to qualify for equity classification (rather than as a liability) to permit withholding up to the maximum statutory tax rates (rather than the minimum as was previously the case) in the applicable jurisdictions. ASU 2016-09 will be effective on January 1, 2017 and is not expected to have a significant impact on the our financial statements.

In April 2016, the FASB issued ASU No. 2016-10, “Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing” (“ASU 2016-10”). ASU 2016-10 was issued to clarify ASC Topic 606, “Revenue from Contracts with Customers” related to (i) identifying performance obligations; and (ii) the licensing implementation guidance. The effective date and transition of ASU 2016-10 is the same as the effective date and transition of ASU 2014-09, “Revenue from Contracts with Customers (Topic 606),” as discussed above. We are currently evaluating the potential impact of ASU 2016-10 on our financial statements.

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments” (“ASU 2016-13”). 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. The amendments in ASU 2016-13 are effective for fiscal years beginning after December 31, 2019, and interim periods within those years for public business entities that are SEC filers. Early adoption is permitted for fiscal years, and interim periods within those years, beginning after

December 15, 2018. We are currently evaluating the impact that the adoption of this standard will have on our financial statements.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments" ("ASU 2016-15"). ASU 2016-15 provides guidance related to certain cash flow issues in order to reduce the current and potential future diversity in practice. ASU 2016-15 will be effective on January 1, 2018 and is not expected to have a significant impact on our financial statements.

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Results of Operations

Net income attributable to common stockholders was \$5.5 million (\$0.42 per diluted common share) for the three months ended September 30, 2016 compared with \$4.0 million (\$0.40 per diluted common share) for the three months ended September 30, 2015, an increase in net income attributable to common stockholders of \$1.4 million or 35.1%. Annualized returns on average common equity were 7.77% and 8.27%, annualized returns on average tangible common equity were 9.21% and 10.77%, annualized returns on average assets were 0.90% and 0.85%, and efficiency ratios were 60.34% and 65.04% for the three months ended September 30, 2016 and September 30, 2015, 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 branch assets, loans and securities. Additionally, taxes and provision for loan losses are not part of this calculation.

Net income attributable to common stockholders was \$17.1 million (\$1.31 per diluted common share) for the nine months ended September 30, 2016 compared with \$11.0 million (\$1.10 per diluted common share) for the nine months ended September 30, 2015, an increase in net income attributable to common stockholders of \$6.1 million or 55.1%. This increase was primarily the result of the increase in average interest-earning assets due to organic growth within the loan portfolio and the increase in the securities portfolio. Additionally, net income increased partially due to the sale of two Central Texas branch locations during the first quarter 2016, resulting in after tax gain of \$1.3 million. Excluding the gain on the sale of the two Central Texas branch locations, net income attributable to common stockholders would have been \$15.8 million and net income per diluted common share would have been \$1.20 for the nine months ended September 30, 2016. Annualized returns on average common equity were 8.40% and 7.75%, annualized returns on average tangible common equity were 10.03% and 10.16% and annualized returns on average assets were 0.99% and 0.82% for the nine months ended September 30, 2016 and September 30, 2015, respectively. Excluding the gain on the sale of the two Central Texas branch locations, the average common equity, average tangible common equity and annualized returns on average assets for the nine months ended September 30, 2016 would have been 7.75%, 9.24% and 0.92%, respectively. Our efficiency ratio was 61.37% and 66.31% for the nine months ended September 30, 2016 and September 30, 2015, respectively.

Net Interest Income

Three months ended September 30, 2016 compared with three months ended September 30, 2015. Net interest income before the provision for loan losses for the three months ended September 30, 2016 was \$23.4 million compared with \$20.4 million for the three months ended September 30, 2015, an increase of \$3.0 million, or 14.7%. The increase in net interest income was primarily due to organic loan growth and an increase in the securities portfolio.

Interest income was \$26.3 million for the three months ended September 30, 2016, an increase of \$3.7 million, or 16.2%, compared with the three months ended September 30, 2015, primarily due to an increase of \$400.0 million, or 22.4%, in average interest-earning assets. Additionally, during the three months ended September 30, 2016 and September 30, 2015, we benefitted from acquisition accounting loan discount accretion of \$309 thousand and \$618 thousand, respectively.

Interest expense was \$2.9 million for the three months ended September 30, 2016, an increase of \$672 thousand compared to the three months ended September 30, 2015. This increase was primarily due to an increase in average interest-bearing liabilities of \$296.4 million for the three months ended September 30, 2016 compared to the three months ended September 30, 2015. This increase in average interest-bearing liabilities was primarily attributable to the increase in average certificates and other time deposits of \$120.2 million for the three months ended September 30, 2016 compared to the three months ended September 30, 2015.

Tax equivalent net interest margin, defined as net interest income adjusted for tax-free income divided by average interest-earning assets, for the three months ended September 30, 2016 was 4.39%, a decrease of 22 basis points compared to 4.61% for the three months ended September 30, 2015. 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 impact of net acquisition accounting adjustments of \$335 thousand and \$750 thousand on the tax equivalent net interest margin was an increase of 6 basis points and 17 basis points for the three months ended

September 30, 2016 and September 30, 2015, respectively.

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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.

	Three Months Ended September 30,					
	2016			2015		
	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 ⁽³⁾	\$1,784,763	\$24,057	5.36 %	\$1,572,441	\$21,627	5.46 %
Securities	310,769	2,112	2.70 %	162,308	975	2.38 %
Deposits in other financial institutions	92,928	150	0.64 %	53,759	43	0.31 %
Total interest-earning assets	2,188,460	\$26,319	4.78 %	1,788,508	\$22,645	5.02 %
Allowance for loan losses	(15,575)			(10,618)		
Noninterest-earning assets	249,363			201,952		
Total assets	\$2,422,248			\$1,979,842		
Liabilities and Stockholders' Equity						
Interest-Bearing Liabilities:						
Interest-bearing demand deposits	\$111,497	\$95	0.34 %	\$97,488	\$77	0.31 %
Money market and savings deposits	484,587	556	0.46 %	432,654	468	0.43 %
Certificates and other time deposits	668,092	1,872	1.11 %	547,884	1,287	0.93 %
Short-term borrowings	44,163	63	0.57 %	106,533	47	0.17 %
Subordinated debt	9,151	123	5.35 %	9,060	114	5.01 %
Other borrowed funds	200,569	201	0.40 %	28,069	245	3.46 %
Total interest-bearing liabilities	1,518,059	\$2,910	0.76 %	1,221,688	\$2,238	0.73 %
Noninterest-Bearing liabilities:						
Noninterest-bearing demand deposits	614,303			555,060		
Other liabilities	9,821			7,292		
Total liabilities	2,142,183			1,784,040		
Stockholders' equity	280,065			195,802		
Total liabilities and stockholders' equity	\$2,422,248			\$1,979,842		
Net interest rate spread			4.02 %			4.29 %
Net interest income and margin ⁽¹⁾		\$23,409	4.26 %		\$20,407	4.53 %
Net interest income and margin (tax equivalent) ⁽²⁾		\$24,149	4.39 %		\$20,770	4.61 %

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

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 (2) 35% for the three months ended September 30, 2016 and September 30, 2015 and other applicable effective tax rates.

(3) Includes loans held for sale at September 30, 2015.

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Nine months ended September 30, 2016 compared with nine months ended September 30, 2015. Net interest income before provision for loan losses for the nine months ended September 30, 2016 was \$66.4 million compared with \$58.9 million for the nine months ended September 30, 2015, an increase of \$7.5 million, or 12.8%. The increase in net interest income was primarily due to organic growth within the loan portfolio and the increase in the securities portfolio during the nine months ended September 30, 2016.

Interest income was \$74.3 million for the nine months ended September 30, 2016, an increase of \$9.0 million, or 13.8%, compared with the nine months ended September 30, 2015, primarily due to an increase of \$6.1 million in interest income and fees on loans during the nine months ended September 30, 2016 compared to the same period in 2015 as a result of the increase in average loans outstanding of \$234.8 million, or 15.8% for the same period.

Additionally, during the nine months ended September 30, 2016 and September 30, 2015, we benefitted from acquisition accounting loan discount accretion of \$1.1 million thousand and \$3.0 million, respectively.

Interest expense was \$7.9 million for the nine months ended September 30, 2016, an increase of \$1.5 million compared to the nine months ended September 30, 2015. This increase was primarily attributable to the increase in average certificates and other time deposits of \$88.4 million for the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015.

Tax equivalent net interest margin, defined as net interest income adjusted for tax-free income divided by average interest-earning assets, for the nine months ended September 30, 2016 was 4.39%, a decrease of 32 basis points compared to 4.71% for the nine months ended September 30, 2015. The impact of net acquisition accounting adjustments of \$1.2 million and \$3.4 million on the tax equivalent net interest margin was an increase of 8 basis points and 27 basis points for the nine months ended September 30, 2016 and September 30, 2015, respectively.

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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 Nine Months Ended September 30,					
	2016			2015		
	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 ⁽³⁾	\$1,724,494	\$69,124	5.35 %	\$1,489,690	\$63,012	5.66 %
Securities	256,149	4,731	2.47 %	127,863	2,135	2.23 %
Deposits in other financial institutions	93,700	442	0.63 %	72,182	167	0.31 %
Total interest-earning assets	2,074,343	\$74,297	4.78 %	1,689,735	\$65,314	5.17 %
Allowance for loan losses	(14,401)			(9,466)		
Noninterest-earning assets	237,765			210,039		
Total assets	\$2,297,707			\$1,890,308		
Liabilities and Stockholders' Equity						
Interest-Bearing Liabilities:						
Interest-bearing demand deposits	\$103,215	\$250	0.32 %	\$101,636	\$256	0.34 %
Money market and savings deposits	451,314	1,514	0.45 %	419,814	1,326	0.42 %
Certificates and other time deposits	636,877	5,097	1.07 %	548,411	3,642	0.89 %
Short-term borrowings	86,106	308	0.48 %	37,384	49	0.17 %
Subordinated debt	9,125	360	5.27 %	8,981	439	6.54 %
Other borrowed funds	106,774	326	0.41 %	28,069	691	3.29 %
Total interest-bearing liabilities	1,393,411	\$7,855	0.75 %	1,144,295	\$6,403	0.75 %
Noninterest-Bearing liabilities:						
Noninterest-bearing demand deposits	624,190			540,499		
Other liabilities	8,545			7,153		
Total liabilities	2,026,146			1,691,947		
Stockholders' equity	271,561			198,361		
Total liabilities and stockholders' equity	\$2,297,707			\$1,890,308		
Net interest rate spread			4.03 %			4.42 %
Net interest income and margin ⁽¹⁾		\$66,442	4.28 %		\$58,911	4.66 %
Net interest income and margin (tax equivalent) ⁽²⁾		\$68,113	4.39 %		\$59,533	4.71 %

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

(2) 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 35% for the nine months ended September 30, 2016 and September 30, 2015 and other applicable effective tax rates.

(3) Includes loans held for sale at September 30, 2015.

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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 Three Months Ended September 30, 2016 vs. 2015			For the Nine Months Ended September 30, 2016 vs. 2015			
	Increase (Decrease) Due to Change in			Increase (Decrease) Due to Change in			
	Volume	Rate	Total	Volume	Rate	Days	Total
	(Dollars in thousands)						
Interest-Earning assets:							
Loans	\$2,920	\$(490)	\$2,430	\$9,968	\$(4,088)	\$231	\$6,111
Securities	887	250	1,137	2,138	450	8	2,596
Deposits in other financial institutions	29	78	107	50	225	1	276
Total increase (decrease) in interest income	3,836	(162)	3,674	12,156	(3,413)	240	8,983
Interest-Bearing liabilities:							
Interest-bearing demand deposits	10	8	18	4	(11)	1	(6)
Money market and savings deposits	54	34	88	95	87	5	187
Certificates and other time deposits	282	303	585	588	854	13	1,455
Short-term borrowings	(28)	44	16	64	196	—	260
Subordinated debt	1	8	9	7	(88)	2	(79)
Other borrowed funds	1,502	(1,546)	(44)	1,939	(2,307)	3	(365)
Total increase (decrease) in interest expense	1,821	(1,149)	672	2,697	(1,269)	24	1,452
Increase (decrease) in net interest income	\$2,015	\$987	\$3,002	\$9,459	\$(2,144)	\$216	\$7,531

Provision for Loan Losses

Our allowance for loan losses is established through charges to income in the form of provisions in order to bring our allowance for loan losses to a level deemed appropriate by management. The allowance for loan losses at September 30, 2016 and December 31, 2015 was \$17.2 million and \$13.1 million, respectively, representing 0.94% and 0.78% of total loans as of such dates. 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. No carryover of any allowance for loan losses occurs when loans are acquired. We recorded a \$2.2 million provision for loan losses for the quarter ended September 30, 2016 and a \$1.5 million provision for the quarter ended September 30, 2015. The increase in the provision was primarily due to organic loan growth and the increase in potential problem loans for the quarter ended September 30, 2016 compared to the quarter ended September 30, 2015.

We recorded a \$4.6 million provision for loan losses for the nine months ended September 30, 2016 and a \$3.6 million provision for the nine months ended September 30, 2015. The increase in the provision was primarily due to organic loan growth and the increase in potential problem loans for the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015.

Noninterest Income

Our primary sources of noninterest income are service charges on deposit accounts and nonsufficient funds fees. 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.

Three months ended September 30, 2016 compared with three months ended September 30, 2015. Noninterest income totaled \$1.3 million for the three months ended September 30, 2016 compared with \$1.2 million for the same period in 2015, an increase of \$73 thousand, or 6.1%.

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Nine months ended September 30, 2016 compared with nine months ended September 30, 2015. Noninterest income totaled \$5.8 million for the nine months ended September 30, 2016 compared with \$3.0 million for the same period in 2015, an increase of \$2.8 million, or 92.1%. This increase was primarily due to the after tax gain of \$1.3 million on the sale of the two Central Texas branch locations completed during the first quarter of 2016.

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

	For the Three			For the Nine		
	Months		Increase (Decrease)	Months		Increase (Decrease)
	Ended	Ended		Ended	Ended	
	September 30,	September 30,		September 30,	September 30,	
	2016	2015		2016	2015	
	(Dollars in thousands)					
Nonsufficient funds fees	\$175	\$179	\$ (4)	\$483	\$512	\$ (29)
Service charges on deposit accounts	182	163	19	500	514	(14)
Debit card and ATM card income	185	171	14	528	463	65
Gain on sale of branch assets	—	—	—	2,050	—	2,050
Gain (loss) on sales of other real estate	60	1	59	60	(5)	65
Gains on sales of loans	—	235	(235)	—	235	(235)
Bank owned life insurance income	154	167	(13)	473	433	40
Rebate from correspondent bank	172	60	112	479	161	318
Other ⁽¹⁾	346	225	121	1,217	701	516
Total noninterest income	\$1,274	\$1,201	\$ 73	\$5,790	\$3,014	\$ 2,776

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

Noninterest Expense

Three months ended September 30, 2016 compared with three months ended September 30, 2015. Noninterest expense was \$14.9 million for the three months ended September 30, 2016 compared to \$13.9 million for the three months ended September 30, 2015, an increase of \$994 thousand, or 7.2%. This increase was primarily attributable to additional salaries and benefits related to the hiring of several key income producing employees over the last year.

Nine months ended September 30, 2016 compared with nine months ended September 30, 2015. Noninterest expense was \$43.1 million for the nine months ended September 30, 2016 compared to \$40.9 million for the nine months ended September 30, 2015, an increase of \$2.2 million, or 5.3%. This increase was primarily attributable to additional salaries and benefits related to the hiring of several key income producing employees over the last year.

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

	For the Three Months Ended September 30,			Increase (Decrease)	For the Nine Months Ended September 30,			Increase (Decrease)
	2016	2015			2016	2015		
	(Dollars in thousands)							
Salaries and employee benefits ⁽¹⁾	\$9,781	\$8,996	\$ 785		\$28,231	\$26,419	\$ 1,812	
Net occupancy and equipment	1,260	1,289	(29)		3,706	3,647	59	
Depreciation	404	414	(10)		1,236	1,190	46	
Data processing and software amortization	655	841	(186)		1,930	2,294	(364)	
Professional fees	442	343	99		1,377	1,220	157	
Regulatory assessments and FDIC insurance	396	296	100		1,096	990	106	
Core deposit intangibles amortization	196	207	(11)		590	622	(32)	
Communications	264	300	(36)		818	992	(174)	
Advertising	228	188	40		626	510	116	
Other real estate expense	118	20	98		198	63	135	
Printing and supplies	80	52	28		175	240	(65)	
Other	1,071	955	116		3,088	2,722	366	
Total noninterest expense	\$14,895	\$13,901	\$ 994		\$43,071	\$40,909	\$ 2,162	

Total salaries and employee benefits includes \$370 thousand and \$310 thousand for the three months ended (1) September 30, 2016 and 2015, respectively, and \$1.1 million and \$951 thousand for the nine months ended September 30, 2016 and 2015, respectively, in stock based compensation expense.

Salaries and Employee Benefits. Salaries and benefits increased \$785 thousand, or 8.7%, for the three months ended September 30, 2016 compared to the same period in 2015 and increased \$1.8 million, or 6.9% for the nine months ended September 30, 2016 as compared to the nine months ended September 30, 2015. These increases for the three and nine months ended September 30, 2016 over the same periods in 2015 were primarily due to additional income-producing employees hired to support our growth over the past year.

Efficiency Ratio

The efficiency ratio is a supplemental financial measure utilized in management's internal evaluation of our performance and is not defined under generally accepted accounting principles. We calculate our efficiency ratio by dividing total noninterest expense, excluding loan loss provisions, by net interest income plus noninterest income, excluding net gains and losses on the sale of branch assets, loans and securities. Additionally, taxes 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 60.34% and 61.37% for the three and nine months ended September 30, 2016, respectively, compared to 65.04% and 66.31% for the three and nine months ended September 30, 2015, respectively.

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 2015 to 2016, demonstrates the scalability of our operating platform. We expect to continue to benefit from our scalable platform in future periods as we believe we have already incurred a significant portion of the overhead expense necessary to support our growth.

Income Taxes

The amount of federal 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 increased \$146 thousand, or 7.5%, to \$2.1 million for the three months ended September 30, 2016 compared with \$2.0 million for the same period in 2015. For the nine months ended September 30, 2016, income tax expense totaled \$7.5 million, an increase of \$1.7 million, or 29.3%, compared with \$5.8 million for the same period in 2015. Our effective tax rates were 27.8% and 30.6% for the three and nine months ended September 30, 2016, respectively, and 31.7% and 33.4% for the three and nine

months ended September 30, 2015, respectively. Our effective tax rate decreased for the three and nine months ended September 30, 2016 compared to the same period in 2015 primarily due to the increase in tax free income from the purchase of additional municipal securities and from cashless exercises of stock options by employees.

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Financial Condition

Loan Portfolio

At September 30, 2016, total loans (including loans held for sale) were \$1.83 billion, an increase of \$177.6 million, or 10.7%, compared with December 31, 2015, primarily due to organic growth in our loan portfolio.

Total loans (including loans held for sale) as a percentage of deposits were 96.3% and 94.0% as of September 30, 2016 and December 31, 2015, respectively. Our capital positions in 2015 and year to date 2016 have allowed us to grow our loan portfolio at a faster rate than we grew our deposits. Total loans as a percentage of assets were 74.4% and 79.3% as of September 30, 2016 and December 31, 2015, respectively.

Lending activities originate from the efforts of our lenders, with an emphasis on lending to small to medium-sized businesses and companies, professionals and individuals located in the Houston metropolitan area.

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

	September 30, 2016	December 31, 2015
	(Dollars in thousands)	
Loans held for sale ⁽¹⁾	\$—	\$27,887
Commercial and industrial	402,273	383,044
Mortgage warehouse	76,043	59,071
Real estate:		
Commercial real estate (including multi-family residential)	848,939	745,595
Commercial real estate construction and land development	167,936	154,646
1-4 family residential (including home equity)	228,651	205,200
Residential construction	93,923	93,848
Consumer and other	12,957	11,761
Total loans held for investment	1,830,722	1,653,165
Total loans	1,830,722	1,681,052
Allowance for loan losses	(17,185)	(13,098)
Loans, net	\$1,813,537	\$1,667,954

Consisted of loans at two former F&M Bancshares locations acquired in 2015 and sold during the first quarter of 2016. At December 31, 2015, loans held for sale consisted of \$13.2 million of commercial and industrial loans, (1) \$11.6 million of commercial real estate (including multi-family residential) loans, \$2.3 million of 1-4 family residential (including home equity) loans and \$803 thousand of consumer and other loans. Loans held for sale were carried at the lower of aggregate cost or fair value.

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 slightly increased by \$19.2 million, or 5.0%, to \$402.3 million as of September 30, 2016 compared to \$383.0 million as of December 31, 2015.

Our exposure to oil and gas exploration and production companies is roughly 3.7% of our total loan portfolio as of September 30, 2016. We define these customers as those on whom the prices of oil and gas have a significant operational or financial impact. These loans carry an overall allowance of 2.5% at September 30, 2016. The collateral on these loans includes industrial commercial real estate, working capital assets, machining equipment, drilling equipment, general industrial equipment, vehicles, airplanes, ranch property, insurance policies, notes receivable and a hotel. In addition, substantially all of these loans are personally guaranteed by the owner or owners of the borrower companies.

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

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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. Our mortgage warehouse portfolio increased \$17.0 million, or 28.7%, to \$76.0 million as of September 30, 2016 compared to \$59.1 million as of December 31, 2015. Volumes fluctuate based on the level of market demand for the product, as well as overall market interest rates, and tend to peak at the end of each month.

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 September 30, 2016 and December 31, 2015, 51.1% and 52.8%, respectively, of our commercial real estate loans were owner-occupied. Our commercial real estate loan portfolio increased \$103.3 million, or 13.9%, to \$848.9 million as of September 30, 2016 from \$745.6 million as of December 31, 2015, as a result of organic loan growth in the commercial real estate portfolio during the first nine months of 2016.

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.

Commercial real estate construction and land development loans increased \$13.3 million, or 8.6%, to \$167.9 million as of September 30, 2016 compared to \$154.6 million as of December 31, 2015 as a result of organic loan growth in the commercial real estate construction portfolio during the first nine months of 2016.

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 areas. Our residential real estate portfolio (including home equity) increased \$23.5 million, or 11.4%, to \$228.7 million as of September 30, 2016 from \$205.2 million as of December 31, 2015 as a result of organic loan growth in the 1-4 family residential portfolio during the first nine months of 2016.

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 \$75 thousand, or 0.1%, to \$93.9 million as of September 30, 2016 from \$93.8 million as of December 31, 2015 as a result of organic loan growth in the residential construction portfolio during the first nine months of 2016.

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 \$1.2 million, or 10.2%, to \$13.0 million as of September 30, 2016 from \$11.8 million as of December 31, 2015.

Asset Quality**Nonperforming Assets**

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 \$15.9 million and \$5.2 million in nonperforming loans as of September 30, 2016 and December 31, 2015, respectively.

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

	As of September 30, 2016	As of December 31, 2015		
	(Dollars in thousands)			
Nonaccrual loans:				
Loans held for sale	\$—	\$ 209		
Commercial and industrial	4,983	2,664		
Mortgage warehouse	—	—		
Real estate:				
Commercial real estate (including multi-family residential)	10,495	2,006		
Commercial real estate construction and land development	—	—		
1-4 family residential (including home equity)	11	239		
Residential construction	—	—		
Consumer and other	393	66		
Total nonaccrual loans	15,882	5,184		
Accruing loans 90 or more days past due	—	—		
Total nonperforming loans	15,882	5,184		
Reposessed assets	1,138	—		
Other real estate	30	131		
Total nonperforming assets	\$ 17,050	\$ 5,315		
Restructured loans ⁽¹⁾	\$ 4,667	\$ 491		
Nonperforming assets to total assets	0.69	%	0.25	%
Nonperforming loans to total loans	0.87	%	0.31	%

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

Potential problem loans consist of accruing restructured and impaired 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 September 30, 2016 and December 31, 2015, we had \$5.2 million and \$6.4 million, respectively, in loans of this type which are not included in any of the nonaccrual or 90 days past due loan categories. At September 30, 2016, potential problem loans consisted of ten credit relationships. Of the total outstanding balance at September 30, 2016, 94.1% related to nine customers in the energy related industry and 5.9% related to one customer in the clothing manufacturing 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 September 30, 2016 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 allocation methodology.

Allowance for Credit 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) provisions for loan losses charged to earnings that increase the allowance, (2) charge-offs of loans that occur when loans are deemed uncollectible and decrease the allowance and (3) recoveries on loans previously charged off that increase the allowance.

All loans acquired from F&M Bancshares were recorded at fair value without a carryover of the F&M Bancshares 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 date of the F&M Bancshares acquisition was \$6.0 million, or 1.47%, on loans acquired. The remaining discount on F&M Bancshares acquired loans as of September 30, 2016 was \$1.2 million, or 0.74%. The discount on purchased loans considers anticipated credit losses on that portfolio, therefore no allowance for credit losses was established on the

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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 September 30, 2016, our allowance for loan losses amounted to \$17.2 million, or 0.94%, of total loans compared with \$13.1 million, or 0.78%, as of December 31, 2015. Excluding the acquired loans, the allowance would have been 1.06% of total loans at September 30, 2016. The increase in the allowance of \$4.1 million for the nine months ended September 30, 2016 as compared to the year ended December 31, 2015 was primarily due to an increase in the required reserve associated with organic loan growth and the increase in potential problem loans. We believe that the allowance for loan losses at September 30, 2016 and December 31, 2015 was adequate to cover probable incurred losses in the loan portfolio as of such dates. The ratio of annualized net charge-offs to average loans outstanding was 0.04% for the nine months ended September 30, 2016 compared to 0.06% for the nine months ended September 30, 2015 and 0.06% for the year ended December 31, 2015.

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 Nine Months Ended September 30,			
	2016		2015	
	(Dollars in thousands)			
Average loans outstanding	\$1,724,494		\$1,489,690	
Gross loans outstanding at end of period	1,830,722		1,616,416	
Allowance for loan losses at beginning of period	13,098		8,246	
Provision for loan losses	4,569		3,633	
Charge-offs:				
Commercial and industrial loans	(451)	(723)
Mortgage warehouse	—		—	
Real estate:				
Commercial real estate (including multi-family residential)	(129)	—	
Commercial real estate construction and land development	—		—	
1-4 family residential (including home equity)	—		—	
Residential construction	—		—	
Consumer and other	(26)	(26)
Total charge-offs for all loan types	(606)	(749)
Recoveries:				
Commercial and industrial loans	67		46	
Mortgage warehouse	—		—	
Real estate:				
Commercial real estate (including multi-family residential)	43		—	
Commercial real estate construction and land development	—		—	
1-4 family residential (including home equity)	10		—	
Residential construction	—		24	
Consumer and other	4		4	
Total recoveries for all loan types	124		74	
Net charge-offs	(482)	(675)
Allowance for loan losses at end of period	\$17,185		\$11,204	
Allowance for loan losses to total loans	0.94	%	0.69	%
Net charge-offs to average loans ⁽¹⁾	0.04	%	0.06	%
Allowance for loan losses to nonperforming loans	108.20	%	181.15	%

(1) Interim period annualized.

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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, and to meet pledging requirements. As of September 30, 2016, the carrying amount of investment securities totaled \$310.0 million, an increase of \$144.9 million, or 87.8%, compared with \$165.1 million as of December 31, 2015. Securities represented 12.6% and 7.9% of total assets as of September 30, 2016 and December 31, 2015, respectively.

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:

	September 30, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
U.S. Government and agency securities	\$5,871	\$ 474	\$ —	\$6,345
Municipal securities	222,299	6,722	(91)	228,930
Agency mortgage-backed pass-through securities	25,676	634	(69)	26,241
Corporate bonds	47,957	560	—	48,517
Total	\$301,803	\$ 8,390	\$ (160)	\$310,033
	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
U.S. Government and agency securities	\$8,674	\$ 412	\$ —	\$9,086
Municipal securities	123,809	2,575	(35)	126,349
Agency mortgage-backed pass-through securities	29,511	397	(246)	29,662
Total	\$161,994	\$ 3,384	\$ (281)	\$165,097

As of September 30, 2016, we do 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 September 30, 2016, management believes any impairment in our securities is temporary, and no impairment loss has been realized in our consolidated statements of income.

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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.

September 30, 2016												
		Within One Year		After One Year but Within Five Years		After Five Years but Within Ten Years		After Ten Years		Total		
		Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Total	Yield	
(Dollars in thousands)												
Available for Sale												
U.S. government and agency securities												
	\$—	—	%	\$2,013	1.46%	\$3,858	3.37%	\$—	—	%	\$5,871	2.71%
Municipal securities												
	2,748	1.76%		18,365	2.72%	76,300	3.18%	124,886	4.93%	222,299	4.11%	
Agency mortgage-backed pass-through securities												
	—	—	%	—	—	4,953	2.13%	20,723	2.00%	25,676	2.03%	
Corporate bonds												
	—	—	%	47,957	2.35%	—	—	—	—	47,957	2.35%	
Total												
	\$2,748	1.76%		\$68,335	2.42%	\$85,111	3.13%	\$145,609	4.51%	\$301,803	3.62%	

December 31, 2015												
		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												
	\$—	—	%	\$2,010	1.46%	\$6,664	3.23%	\$—	—	%	\$8,674	2.82%
Municipal securities												
	7,176	1.48%		15,290	2.53%	32,078	3.22%	69,265	4.75%	123,809	3.89%	
Agency mortgage-backed pass-through securities												
	—	—	%	—	—	4,328	2.22%	25,183	2.54%	29,511	2.49%	
Agency collateralized mortgage obligations												
	—	—	%	—	—	—	—	—	—	—	—	
Total												
	\$7,176	1.48%		\$17,300	2.41%	\$43,070	3.12%	\$94,448	4.16%	\$161,994	3.58%	

The contractual maturity of mortgage-backed securities and collateralized mortgage obligations is not a reliable indicator of their expected life because borrowers may 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 September 30, 2016 and December 31, 2015, 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 stockholders' equity.

The average yield of our securities portfolio was 2.47% during the nine months ended September 30, 2016 compared with 2.23% for the nine months ended September 30, 2015. The increase in average yield during the first nine months of 2016 compared to the same period in 2015 was primarily due to our increased investment in the securities portfolio. This investment in higher-yielding securities replaced lower-yielding securities that matured, were called or prepaid.

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Goodwill and Core Deposit Intangible Assets

Our goodwill as of September 30, 2016 and December 31, 2015 was \$39.4 million for both periods. Goodwill resulting from business combinations represents the excess of the consideration paid over the fair value of the net assets acquired and liabilities assumed. 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 intangible assets, net as of September 30, 2016 and December 31, 2015, was \$4.3 million and \$5.2 million, respectively, and decreased primarily as a result of the sale of the two Central Texas branch locations during the first quarter of 2016. Core deposit intangible assets arising from the F&M Bancshares acquisition and the Independence acquisition are amortized using a straight-line amortization method over its estimated useful life of seven to nine 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 September 30, 2016 were \$1.90 billion, an increase of \$141.7 million, or 8.1%, compared with \$1.76 billion at December 31, 2015. Noninterest-bearing deposits at September 30, 2016 were \$604.3 million, a decrease of \$16.0 million, or 2.6%, compared with \$620.3 million at December 31, 2015. Interest-bearing deposits at September 30, 2016 were \$1.30 billion, an increase of \$157.8 million, or 13.9%, compared with \$1.14 billion at December 31, 2015.

Borrowings

We have an available line of credit with the FHLB of Dallas, which allows us to borrow on a collateralized basis. Our FHLB advances are short-term borrowings and are used to manage liquidity as needed. Maturing advances are replaced by drawing on available cash, making additional borrowings or through increased customer deposits. At September 30, 2016, we had a total borrowing capacity of \$652.7 million, of which \$359.4 million was available and \$293.4 million was outstanding. Short-term FHLB advances of \$61.0 million were outstanding at September 30, 2016, at a weighted average interest rate of 0.56%. Long-term FHLB borrowings of \$200.0 million were outstanding at September 30, 2016, at a weighted average interest rate of 0.37%. Letters of credit were \$32.4 million at September 30, 2016, of which \$25.0 million will expire in October 2016, \$3.0 million will expire in February 2017 and \$4.3 million will expire in August 2017.

Credit Agreement

As of September 30, 2016 and December 31, 2015, we had \$569 thousand of indebtedness owed to another financial institution. On December 22, 2014, in connection with the acquisition of F&M Bancshares, we entered into a revolving credit agreement. Pursuant to this agreement, we borrowed approximately \$10.1 million in December 2014 to pay off the prior indebtedness. In January 2015, we borrowed an additional \$18.0 million under the revolving credit agreement to repay debt that F&M Bancshares owed. In October 2015, we paid down \$27.5 million under the revolving credit agreement with a portion of the proceeds from the Company's initial public offering.

Our borrowing under the revolving credit agreement matures in December 2021. Interest accrues on borrowed funds at the Prime Rate minus 25 basis points, which equated to approximately 3.25% at September 30, 2016. Interest payments are due quarterly. The revolving credit agreement is secured by 100% of the capital stock of the Bank. The maximum commitment to advance funds under the revolving credit agreement is \$30.0 million, which is reduced by \$4.3 million on each December 22nd, beginning on December 22, 2015. We are required to repay any outstanding balance in excess of the then-current maximum commitment amount.

The revolving 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 September 30, 2016, we believe we are in compliance with all such debt covenants and the lender has not delivered any notice of noncompliance under the terms of the applicable credit documents.

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Contractual Obligations

The following table summarizes our contractual obligations and other commitments to make future payments as of September 30, 2016 and December 31, 2015 (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 September 30, 2016				
	1 year or less	More than 1 year but less than 3 years	3 years or more but less than 5 years	5 years or more	Total
	(Dollars in thousands)				
Bank loan	\$—	\$ —	\$ —	\$ 569	\$ 569
Operating leases	787	2,539	2,749	4,498	10,573
Total	\$ 787	\$ 2,539	\$ 2,749	\$ 5,067	\$ 11,142
	As of December 31, 2015				
	1 year or less	More than 1 year but less than 3 years	3 years or more but less than 5 years	5 years or more	Total
	(Dollars in thousands)				
Bank loan	\$—	\$ —	\$ —	\$ 569	\$ 569
Operating leases	2,379	4,303	2,370	2,725	11,777
Total	\$ 2,379	\$ 4,303	\$ 2,370	\$ 3,294	\$ 12,346

Off-Balance Sheet Items

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

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 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 contain security and debt covenants similar to those contained in loan agreements.

As of September 30, 2016 and December 31, 2015, we had outstanding \$535.2 million and \$474.9 million, respectively, in commitments to extend credit and \$8.4 million and \$9.5 million, respectively, in commitments associated with outstanding standby 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.

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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, 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 nine months ended September 30, 2016 and the year ended December 31, 2015, our liquidity needs have been met by core deposits, 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.

Our largest source of funds is deposits and our largest use of funds is loans. Our average loans increased \$234.8 million, or 15.8%, for the nine months ended September 30, 2016 compared with the nine months ended September 30, 2015. 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 6.5 years and modified duration of 5.6 years at September 30, 2016, and a weighted average life of 7.0 years and modified duration of 6.0 years at December 31, 2015.

As of September 30, 2016 and December 31, 2015, we had no exposure to future cash requirements associated with known uncertainties or capital expenditures of a material nature.

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 company 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 stockholders' equity (including retained earnings), less goodwill, other disallowed intangible assets, 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 September 30, 2016 and December 31, 2015, the Bank was well-capitalized.

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Total stockholder's equity was \$281.1 million at September 30, 2016, compared with \$258.5 million at December 31, 2015, an increase of \$22.6 million, or 8.7%. This increase was primarily the result of net income of \$17.1 million for the nine months ended September 30, 2016.

The following table provides a comparison our leverage and risk-weighted capital ratios as of the dates indicated to the minimum and well-capitalized regulatory standards:

	Minimum Required For Capital Adequacy Purposes		To Be Categorized As Well Capitalized Under Prompt Corrective Action Provisions	Actual Ratio
ALLEGIANCE BANCSHARES, INC.				
(Consolidated)				
As of September 30, 2016				
Common equity Tier 1 capital (to risk weighted assets)	4.50	%	N/A	11.40%
Leverage ratio (to average assets)	4.00	%	N/A	10.25%
Tier 1 risk-based capital ratio (to risk weighted assets)	6.00	%	N/A	11.84%
Total risk-based capital ratio (to risk weighted assets)	8.00	%	N/A	12.68%
As of December 31, 2015				
Common equity Tier 1 capital (to risk weighted assets)	4.50	%	N/A	11.72%
Leverage ratio (to average assets)	4.00	%	N/A	11.02%
Tier 1 risk-based capital ratio (to risk weighted assets)	6.00	%	N/A	12.21%
Total risk-based capital ratio (to risk weighted assets)	8.00	%	N/A	12.92%
	Minimum Required For Capital Adequacy Purposes		To Be Categorized As Well Capitalized Under Prompt Corrective Action Provisions	Actual Ratio
ALLEGIANCE BANK:				
As of September 30, 2016				
Common equity Tier 1 capital (to risk weighted assets)	4.50	%	6.50	% 10.90%
Leverage ratio (to average assets)	4.00	%	5.00	% 9.43 %
Tier 1 risk-based capital ratio (to risk weighted assets)	6.00	%	8.00	% 10.90%
Total risk-based capital ratio (to risk weighted assets)	8.00	%	10.00	% 11.74%
As of December 31, 2015				
Common equity Tier 1 capital (to risk weighted assets)	4.50	%	6.50	% 11.25%
Leverage ratio (to average assets)	4.00	%	5.00	% 10.16%
Tier 1 risk-based capital ratio (to risk weighted assets)	6.00	%	8.00	% 11.25%
Total risk-based capital ratio (to risk weighted assets)	8.00	%	10.00	% 11.96%

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**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

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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 September 30, 2016	As of December 31, 2015	As of September 30, 2016	As of December 31, 2015
+300	(2.3)%	5.2%	(4.9)%	(0.4)%
+200	(1.8)%	3.0%	(2.9)%	(0.1)%
+100	(1.3)%	1.0%	(1.3)%	0.0%
Base	0.0%	0.0%	0.0%	0.0%
-100	2.7%	1.5%	0.1%	(0.6)%

These results are primarily due to behavior of demand, money market and savings deposits during such rate fluctuations. We have found that, historically, interest rates on these deposits change more slowly than changes in the discount and federal funds rates.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. As of the end of the period covered by this Quarterly Report on Form 10-Q, the Company carried out an evaluation, under the supervision and with the participation of its

management, including its Chief Executive Officer and Interim 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 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 Interim Chief Financial Officer concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act

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of 1934, as amended (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 Interim Chief Financial Officer.

Changes in internal control over financial reporting. There were no changes in the Company’s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are subject to claims and litigation arising in the ordinary course of business. In the opinion of management, we are not party to any legal proceedings the resolution of which we believe would have a material adverse effect on our business, prospects, financial condition, liquidity, results of operation, cash flows or capital levels. However, one or more unfavorable outcomes in any claim or litigation against us could have a material adverse effect for the period in which such claim or litigation is resolved. In addition, regardless of their merits or their ultimate outcomes, such matters are costly, divert management’s attention and may materially adversely affect our reputation, even if resolved in our favor. We intend to defend ourselves vigorously against any future claims or litigation.

ITEM 1A. RISK FACTORS

In evaluating an investment in any of the Company’s securities, investors should consider carefully, among other things, information under the heading “Cautionary Note Regarding Forward-Looking Statements” in this Form 10-Q, the risk factors previously disclosed under the heading “Risk Factors” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015, and such other risk factors as the Company may disclose or has disclosed in other reports and statements filed with the Securities and Exchange Commission.

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

(a) None.

(b) None.

(c) None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS

Exhibit Number	Description
3.1	Amended and Restated Certificate of Formation of Allegiance Bancshares, Inc. (incorporated herein by reference to Exhibit 3.1 to the Company’s Registration Statement on Form S-1 (Registration No. 333-206536) (the “Registration Statement”))
3.2	Amended and Restated Bylaws of Allegiance Bancshares, Inc. (incorporated herein by reference to Exhibit 3.2 to the Registration Statement)
4.1	Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 to the Registration Statement)
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 President and Interim 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 President and Interim 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
	* Filed with this Quarterly Report on Form 10-Q.
	**Furnished with this Quarterly Report on Form 10-Q.

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SIGNATURES

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

Allegiance Bancshares, Inc.
(Registrant)

Date: November 10, 2016 /s/ George Martinez
George Martinez
Chairman and Chief Executive Officer

Date: November 10, 2016 /s/ Steven F. Retzloff
Steven F. Retzloff
President and Interim Chief Financial Officer