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People's Utah Bancorp  
Form 10-Q  
August 08, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2017

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 001-37416

PEOPLE'S UTAH BANCORP

(Exact name of registrant as specified in its charter)

UTAH  
(State or other jurisdiction of  
incorporation or organization)

87-0622021  
(IRS Employer  
Identification No.)

1 East Main Street, American Fork, Utah 84003  
(Address of principal executive offices) (Zip Code)

(801) 642-3998

Registrant's telephone number, including area code

Not Applicable

(Former name, former address, and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

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

Emerging growth company

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

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of Registrant’s common stock outstanding on July 31, 2017 was 17,958,487. No preferred shares are issued or outstanding.

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## PEOPLE'S UTAH BANCORP AND SUBSIDIARIES

## UNAUDITED CONSOLIDATED BALANCE SHEETS

| (Dollars in thousands, except share data)  | June 30,<br>2017 | December<br>31,<br>2016 |
|--|------------------|-------------------------|
| <b>ASSETS</b>  |                  |                         |
| Cash and cash equivalents:   |                  |                         |
| Cash and due from banks  | \$28,315         | \$26,524                |
| Interest bearing deposits  | 26,027           | 37,958                  |
| Federal funds sold   | 3,093            | 3,456                   |
| Total cash and cash equivalents  | 57,435           | 67,938                  |
| Investment securities:   |                  |                         |
| Available-for-sale, at fair value  | 325,172          | 335,609                 |
| Held-to-maturity, at historical cost   | 77,394           | 73,512                  |
| Total investment securities  | 402,566          | 409,121                 |
| Non-marketable equity securities   | 1,959            | 1,827                   |
| Loans held for sale  | 7,655            | 20,826                  |
| Loans:   |                  |                         |
| Loans held for investment  | 1,201,391        | 1,119,877               |
| Less allowance for loan losses   | (17,271 )        | (16,715 )               |
| Total loans held for investment, net   | 1,184,120        | 1,103,162               |
| Premises and equipment, net  | 23,551           | 21,926                  |
| Bank-owned life insurance  | 19,970           | 19,714                  |
| Deferred income tax assets   | 9,845            | 9,799                   |
| Accrued interest receivable  | 5,616            | 5,557                   |
| Other real estate owned  | 468              | 245                     |
| Other assets   | 5,190            | 5,866                   |
| Total assets   | \$1,718,375      | \$1,665,981             |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                  |                         |
| Deposits:  |                  |                         |
| Non-interest bearing deposits  | \$465,988        | \$443,100               |
| Interest bearing deposits  | 995,064          | 981,974                 |
| Total deposits   | 1,461,052        | 1,425,074               |
| Short-term borrowings  | 3,302            | 3,199                   |
| Accrued interest payable   | 269              | 305                     |
| Other liabilities  | 13,850           | 8,886                   |
| Total liabilities  | 1,478,473        | 1,437,464               |
| Commitments and contingencies  |                  |                         |
| Shareholders' equity:  |                  |                         |
| Preferred shares, \$0.01 par value: 3,000,000 shares authorized, no shares issued  | —                | —                       |
| Common shares, \$0.01 par value: 30,000,000 shares authorized; 17,948,347 and 17,819,538 shares issued and outstanding as of June 30, 2017 and December 31, 2016, respectively | 179              | 178                     |

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|  |             |             |
|--|-------------|-------------|
| Additional paid-in capital                 | 69,623      | 68,657      |
| Retained earnings                          | 170,840     | 160,692     |
| Accumulated other comprehensive loss       | (740 )      | (1,010 )    |
| Total shareholders' equity                 | 239,902     | 228,517     |
| Total liabilities and shareholders' equity | \$1,718,375 | \$1,665,981 |

See accompanying notes to the unaudited consolidated financial statements.

## PEOPLE'S UTAH BANCORP AND SUBSIDIARIES

## UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

| (Dollars in thousands, except share and per share data) | Three Months Ended |            | Six Months Ended |            |
|---|--------------------|------------|------------------|------------|
|   | June 30,<br>2017   | 2016       | June 30,<br>2017 | 2016       |
| <b>Interest income</b>                                  |                    |            |                  |            |
| Interest and fees on loans                              | \$17,928           | \$16,420   | \$34,781         | \$32,271   |
| Interest and dividends on investments                   | 1,802              | 1,489      | 3,507            | 3,092      |
| Total interest income                                   | 19,730             | 17,909     | 38,288           | 35,363     |
| Interest expense  | 749                | 698        | 1,515            | 1,452      |
| Net interest income                                     | 18,981             | 17,211     | 36,773           | 33,911     |
| Provision for loan losses                               | 900                | 225        | 1,100            | 425        |
| Net interest income after provision for loan losses     | 18,081             | 16,986     | 35,673           | 33,486     |
| <b>Non-interest income</b>                              |                    |            |                  |            |
| Mortgage banking  | 1,960              | 2,277      | 3,939            | 4,025      |
| Card processing   | 1,208              | 1,136      | 2,332            | 2,167      |
| Service charges on deposit accounts                     | 578                | 531        | 1,114            | 1,044      |
| Other operating   | 602                | 454        | 1,088            | 925        |
| Total non-interest income                               | 4,348              | 4,398      | 8,473            | 8,161      |
| <b>Non-interest expense</b>                             |                    |            |                  |            |
| Salaries and employee benefits                          | 7,762              | 7,959      | 15,729           | 15,843     |
| Occupancy, equipment and depreciation                   | 1,088              | 1,076      | 2,205            | 2,064      |
| Data processing   | 661                | 740        | 1,336            | 1,447      |
| Card processing   | 516                | 549        | 1,045            | 1,139      |
| Marketing and advertising                               | 349                | 290        | 611              | 459        |
| FDIC premiums   | 130                | 188        | 256              | 383        |
| Other   | 1,845              | 1,598      | 3,625            | 3,200      |
| Total non-interest expense                              | 12,351             | 12,400     | 24,807           | 24,535     |
| Income before income tax expense                        | 10,078             | 8,984      | 19,339           | 17,112     |
| Income tax expense                                      | 3,584              | 3,407      | 6,324            | 6,292      |
| Net income  | \$6,494            | \$5,577    | \$13,015         | \$10,820   |
| <b>Earnings per common share:</b>                       |                    |            |                  |            |
| Basic   | \$0.37             | \$0.31     | \$0.73           | \$0.61     |
| Diluted   | \$0.35             | \$0.31     | \$0.71           | \$0.60     |
| <b>Weighted average common shares outstanding:</b>      |                    |            |                  |            |
| Basic   | 17,937,926         | 17,738,182 | 17,911,125       | 17,685,235 |
| Diluted   | 18,351,531         | 18,173,034 | 18,334,028       | 18,148,713 |

See accompanying notes to the unaudited consolidated financial statements.



PEOPLE'S UTAH BANCORP AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| (Dollars in thousands)   | Three Months              |         | Six Months Ended |          |
|--|---------------------------|---------|------------------|----------|
|  | Ended<br>June 30,<br>2017 | 2016    | 2017             | 2016     |
| Net income   | \$6,494                   | \$5,577 | \$13,015         | \$10,820 |
| Other comprehensive income   |                           |         |                  |          |
| Unrealized holding gains on securities available-for-sale                | 375                       | 675     | 438              | 2,904    |
| Tax effect   | (143 )                    | (258 )  | (168 )           | (1,110 ) |
| Unrealized holding gains on securities available-for-sale,<br>net of tax | 232                       | 417     | 270              | 1,794    |
| Total comprehensive income   | \$6,726                   | \$5,994 | \$13,285         | \$12,614 |

See accompanying notes to the unaudited consolidated financial statements.



## PEOPLE'S UTAH BANCORP AND SUBSIDIARIES

## UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

| (Dollars in thousands, except share data) | Common<br>Shares | Amount | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total      |
|---|------------------|--------|----------------------------------|----------------------|--|------------|
| Balance as of January 1, 2016             | 17,567,154       | \$ 176 | \$ 67,338                        | \$ 142,223           | \$ (329 )  | \$ 209,408 |
| Comprehensive income                      | —                | —      | —                                | 10,820               | 1,794  | 12,614     |
| Cash dividends (\$0.14 per share)         | —                | —      | —                                | (2,475 )             | —  | (2,475 )   |
| Share-based compensation                  | —                | —      | 252                              | —                    | —  | 252        |
| Exercise of stock options                 | 185,666          | 2      | 646                              | —                    | —  | 648        |
| Balance as of June 30, 2016               | 17,752,820       | \$ 178 | \$ 68,236                        | \$ 150,568           | \$ 1,465   | \$ 220,447 |
| Balance as of January 1, 2017             | 17,819,538       | \$ 178 | \$ 68,657                        | \$ 160,692           | \$ (1,010 )  | \$ 228,517 |
| Comprehensive income                      | —                | —      | —                                | 13,015               | 270  | 13,285     |
| Cash dividends (\$0.16 per share)         | —                | —      | —                                | (2,867 )             | —  | (2,867 )   |
| Share-based compensation                  | —                | —      | 218                              | —                    | —  | 218        |
| Exercise of stock options                 | 128,809          | 1      | 748                              | —                    | —  | 749        |
| Balance as of June 30, 2017               | 17,948,347       | \$ 179 | \$ 69,623                        | \$ 170,840           | \$ (740 )  | \$ 239,902 |

See accompanying notes to the unaudited consolidated financial statements.

## PEOPLE'S UTAH BANCORP AND SUBSIDIARIES

## UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

| (Dollars in thousands)   | Six Months Ended |               |
|--|------------------|---------------|
|  | June 30,         | 2016          |
|  | 2017             |               |
| <b>Cash flows from operating activities:</b>   |                  |               |
| Net income   | \$13,015         | \$10,820      |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |                  |               |
| Provision for loan losses  | 1,100            | 425           |
| Depreciation and amortization  | 1,267            | 1,290         |
| Deferred income taxes  | (214 )           | —             |
| Net amortization of securities discounts and premiums                                    | 1,501            | 1,512         |
| Increase in cash surrender value of bank owned life insurance                            | (256 )           | (278 )        |
| Share based compensation   | 218              | 252           |
| Other  | (159 )           | 26            |
| Gain on sale of loans held for sale  | (2,838 )         | (3,033 )      |
| Originations of loans held for sale  | (115,621)        | (123,895)     |
| Proceeds from sale of loans held for sale  | 131,630          | 132,960       |
| <b>Net changes in:</b>   |                  |               |
| Accrued interest receivable  | (59 )            | 181           |
| Other assets   | 676              | 554           |
| Accrued interest payable   | (36 )            | (11 )         |
| Other liabilities  | 4,964            | 3,177         |
| <b>Net cash provided by operating activities</b>   | <b>35,188</b>    | <b>23,980</b> |
| <b>Cash flows from investing activities:</b>   |                  |               |
| Net change in loans held for investment  | (82,558 )        | (47,920 )     |
| Purchase of available-for-sale securities  | (24,599 )        | (12,997 )     |
| Purchase of held-to-maturity securities  | (12,198 )        | —             |
| Proceeds from maturities/sales of available-for-sale securities                          | 34,350           | 66,721        |
| Proceeds from maturities of held-to-maturity securities                                  | 7,939            | 4,143         |
| Purchase of premises and equipment   | (2,758 )         | (1,302 )      |
| Proceeds from sale of other real estate owned, net of improvements                       | 302              | 133           |
| Purchase of non-marketable equity securities   | (2,368 )         | (2,663 )      |
| Proceeds from sale of non-marketable equity securities                                   | 2,236            | 3,080         |
| <b>Net cash (used in) provided by investing activities</b>                               | <b>(79,654 )</b> | <b>9,195</b>  |
| <b>Cash flows from financing activities:</b>   |                  |               |
| Net increase in non-interest bearing deposits  | 22,888           | 21,487        |
| Net increase in interest bearing deposits  | 13,090           | 15,691        |
| Proceeds related to exercise of stock options  | 749              | 648           |
| Net change in short-term borrowings  | 103              | (24,349 )     |
| Cash dividends paid  | (2,867 )         | (2,475 )      |
| <b>Net cash provided by financing activities</b>   | <b>33,963</b>    | <b>11,002</b> |
| <b>Net change in cash and cash equivalents</b>   | <b>(10,503 )</b> | <b>44,177</b> |
| Cash and cash equivalents, beginning of period   | 67,938           | 42,349        |
| Cash and cash equivalents, end of period   | \$57,435         | \$86,526      |

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Supplemental disclosures of cash flow information:

|                        |         |         |
|------------------------|---------|---------|
| Cash paid for interest | \$1,551 | \$1,285 |
| Income taxes paid      | \$6,217 | \$5,610 |

Supplemental disclosures of non-cash transactions:

|   |       |         |
|---|-------|---------|
| Reclassifications from loans to other real estate owned | \$468 | \$237   |
| Unrealized gains on securities available-for-sale       | \$438 | \$2,904 |

See accompanying notes to the unaudited consolidated financial statements.

## PEOPLE'S UTAH BANCORP AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## Note 1 — Basis of Presentation

People's Utah Bancorp, Inc. ("PUB" or the "Company") is a Utah corporation headquartered in American Fork, Utah. The Company's subsidiary is People's Intermountain Bank ("PIB" or the "Bank"), which includes two banking divisions doing business as ("dba") Bank of American Fork ("BAF") and Lewiston State Bank ("LSB"), an equipment leasing division dba GrowthFunding Equipment Finance and a mortgage division dba People's Intermountain Bank Mortgage. BAF and LSB have over 100 years of history and continue to do business as registered names of PIB.

The interim consolidated financial statements include the accounts of the Company together with its subsidiary Bank. All intercompany transactions and balances have been eliminated.

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial information. In the opinion of management, the interim statements reflect all adjustments 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. These financial statements and the accompanying notes should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2016, which are included in the Company's 2016 Form 10-K. Operating results for the three and six months ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017, or any other period.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of real estate acquired through foreclosure, deferred tax assets, and share-based compensation.

Earnings per share — Basic earnings per common share represents income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares include shares that may be issued by the Company for outstanding stock options determined using the treasury stock method and for all outstanding restricted stock units ("RSU").

Earnings per common share have been computed based on the following:

| (Dollars in thousands, except share and per share data) | Three Months Ended |         | Six Months Ended |          |
|---|--------------------|---------|------------------|----------|
|   | June 30,<br>2017   | 2016    | June 30,<br>2017 | 2016     |
| Numerator   |                    |         |                  |          |
| Net income  | \$6,494            | \$5,577 | \$13,015         | \$10,820 |

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Denominator

|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Weighted-average number of common shares outstanding   | 17,937,926 | 17,738,182 | 17,911,125 | 17,685,235 |
| Incremental shares assumed for stock options and RSUs  | 413,605    | 434,852    | 422,903    | 463,478    |
| Weighted-average number of dilutive shares outstanding | 18,351,531 | 18,173,034 | 18,334,028 | 18,148,713 |
| Basic earnings per common share                        | \$0.37     | \$0.31     | \$0.73     | \$0.61     |
| Diluted earnings per common share                      | \$0.35     | \$0.31     | \$0.71     | \$0.60     |

Note 1 — Basis of Presentation – Continued

Reclassifications — Certain amounts in the prior period's financial statements have been reclassified to conform to the current period's presentation.

Impact of Recent Authoritative Accounting Guidance —The Accounting Standards Codification™ (“ASC”) is the Financial Accounting Standards Board’s (“FASB”) officially recognized source of authoritative GAAP applicable to all public and non-public non-governmental entities. Rules and interpretive releases of the SEC under the authority of the federal securities laws are also sources of authoritative GAAP for us as an SEC registrant. All other accounting literature is non-authoritative.

In June 2016, FASB amended FASB ASC Topic 326, Financial Instruments - Credit Losses. The amendments in this Update replace the current incurred loss model with a methodology that reflects expected credit losses over the life of the loan and requires consideration of a broader range of reasonable and supportable information to calculate credit loss estimates. The amendments are effective for public business entities for the first interim and annual reporting periods beginning after December 15, 2019. The Company is currently evaluating the impact of these amendments to the Company’s financial position and results of operations and currently does not know or cannot reasonably quantify the impact of the adoption of the amendments as a result of the complexity and extensive changes from the amendments. The ALLL is a material estimate of the Company and given the change from an incurred loss model to a methodology that considers the credit loss over the life of the loan, there is the potential for an increase in the ALLL at adoption date. The Company is anticipating a significant change in the processes and procedures to calculate the ALLL, including changes in assumptions and estimates to consider expected credit losses over the life of the loan versus the current accounting practice that utilizes the incurred loss model. The Company will also develop new procedures for determining an allowance for credit losses relating to held-to-maturity investment securities. In addition, the current accounting policy and procedures for other-than-temporary impairment on available-for-sale investment securities will be replaced with an allowance approach. The Company is expecting to begin developing and implementing processes and procedures during the next two years to ensure it is fully compliant with the amendments at adoption date. For additional information on the ALLL see Note 3

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (“ASU 2016-09”) which addresses certain aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification of awards on the statement of cash flows. ASU 2016-09 is effective for annual reporting periods beginning after December 15, 2016 and for interim periods within such periods. Early application is permitted. The Company implemented ASU 2016-09 during the annual reporting period of 2016.

## Note 2 — Investment Securities

Amortized cost and estimated fair value of investment securities available-for-sale are summarized as follows:

| (Dollars in thousands)               | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross Unrealized<br>Losses<br>Less Than<br>12 Months<br>or<br>12 Months<br>Longer | Fair<br>Value      |
|--------------------------------------|-------------------|------------------------------|---|--------------------|
| <b>As of June 30, 2017</b>           |                   |                              |   |                    |
| U.S. Government-sponsored securities | \$ 117,202        | \$ 151                       | \$(544 )  | \$(35 ) \$116,774  |
| Municipal securities                 | 18,117            | 385                          | (27 )   | — 18,475           |
| Mortgage-backed securities           | 181,051           | 767                          | (1,096)   | (604 ) 180,118     |
| Corporate securities                 | 10,000            | 55                           | —   | (250 ) 9,805       |
|                                      | \$ 326,370        | \$ 1,358                     | \$(1,667)   | \$(889 ) \$325,172 |
| <b>As of December 31, 2016</b>       |                   |                              |   |                    |
| U.S. Government-sponsored securities | \$ 119,202        | \$ 71                        | \$(669 )  | \$(1 ) \$118,603   |
| Municipal securities                 | 25,176            | 401                          | (58 )   | — 25,519           |
| Mortgage-backed securities           | 182,867           | 679                          | (1,111)   | (614 ) 181,821     |
| Corporate securities                 | 10,000            | 28                           | (32 )   | (330 ) 9,666       |
|                                      | \$ 337,245        | \$ 1,179                     | \$(1,870)   | \$(945 ) \$335,609 |

Note 2 — Investment Securities – continued

Amortized cost and estimated fair value of investment securities held-to-maturity are as follows:

| (Dollars in thousands)  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses<br>Less 12<br>Than<br>Months<br>12<br>or<br>Months<br>Longer | Fair<br>Value     |
|-------------------------|-------------------|------------------------------|--|-------------------|
| As of June 30, 2017     |                   |                              |  |                   |
| Municipal securities    | \$ 77,394         | \$ 505                       | \$(177)  | \$ (13 ) \$77,709 |
| As of December 31, 2016 |                   |                              |  |                   |
| Municipal securities    | \$ 73,512         | \$ 105                       | \$(579)  | \$ (38 ) \$73,000 |

The amortized cost and estimated fair value of investment securities that are available-for-sale and held-to-maturity at June 30, 2017, by contractual maturity, are as follows:

| (Dollars in thousands)             | Available-for-sale<br>Amortized Cost | Fair<br>Value | Held-to-maturity<br>Amortized Cost | Fair<br>Value |
|------------------------------------|--------------------------------------|---------------|------------------------------------|---------------|
| Securities maturing in:            |                                      |               |                                    |               |
| One year or less                   | \$26,252                             | \$26,265      | \$7,774                            | \$7,774       |
| After one year through five years  | 102,578                              | 102,260       | 45,458                             | 45,636        |
| After five years through ten years | 89,162                               | 88,789        | 17,132                             | 17,246        |
| After ten years                    | 108,378                              | 107,858       | 7,030                              | 7,053         |
|                                    | \$326,370                            | \$325,172     | \$77,394                           | \$77,709      |

Actual maturities may differ from contractual maturities because issuers may have the right to call obligations with or without penalties and other securities may experience pre-payments.

As of June 30, 2017 and December 31, 2016, the Company held 254 and 302 investment securities, respectively, with fair value less than amortized cost. Management evaluated these investment securities and determined that the decline in value is temporary and related to the change in market interest rates since purchase. The decline in value is not related to any company or industry specific event. The Company anticipates full recovery of the amortized cost with respect to these securities at maturity, or sooner in the event of a more favorable market interest rate environment.





Note 3 — Loans and Allowance for Loan Losses

Loans are summarized as follows:

| (Dollars in thousands)               | June 30,<br>2017 | December<br>31,<br>2016 |
|--------------------------------------|------------------|-------------------------|
| Loans held for investment:           |                  |                         |
| Commercial real estate loans:        |                  |                         |
| Real estate term                     | \$643,756        | \$582,029               |
| Construction and land development    | 251,741          | 240,120                 |
| Total commercial real estate loans   | 895,497          | 822,149                 |
| Commercial and industrial loans      | 221,901          | 213,260                 |
| Consumer loans:                      |                  |                         |
| Residential and home equity          | 73,791           | 72,959                  |
| Consumer and other                   | 14,936           | 15,678                  |
| Total consumer loans                 | 88,727           | 88,637                  |
| Total gross loans                    | 1,206,125        | 1,124,046               |
| Less:                                |                  |                         |
| Net deferred loan fees               | (4,734 )         | (4,169 )                |
| Total loans held for investment      | 1,201,391        | 1,119,877               |
| Less: allowance for loan losses      | (17,271 )        | (16,715 )               |
| Total loans held for investment, net | \$1,184,120      | \$1,103,162             |

Changes in the allowance for loan losses (“ALLL”) are as follows:

| (Dollars in thousands)                | Three Months Ended June 30, 2017 |                                   |                           |                             |                    |          |
|---------------------------------------|----------------------------------|-----------------------------------|---------------------------|-----------------------------|--------------------|----------|
|                                       | Real Estate Term                 | Construction and Land Development | Commercial and Industrial | Residential and Home Equity | Consumer and Other | Total    |
| Balance at beginning of period        | \$7,149                          | \$ 4,683                          | \$ 4,222                  | \$ 529                      | \$ 61              | \$16,644 |
| Additions: Provisions for loan losses | 181                              | 394                               | 342                       | (28 )                       | 11                 | 900      |
| Deductions:                           |                                  |                                   |                           |                             |                    |          |
| Gross loan charge-offs                | (350 )                           | —                                 | (114 )                    | —                           | (48 )              | (512 )   |
| Recoveries                            | 177                              | —                                 | 39                        | 2                           | 21                 | 239      |
| Net loan charge-offs                  | (173 )                           | —                                 | (75 )                     | 2                           | (27 )              | (273 )   |
| Balance at end of period              | \$7,157                          | \$ 5,077                          | \$ 4,489                  | \$ 503                      | \$ 45              | \$17,271 |

Three Months Ended June 30, 2016  
Real Construction Commercial Residential Consumer

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| (Dollars in thousands)                | Estate<br>Term | and Land<br>Development | and<br>Industrial | and<br>Home<br>Equity | and<br>Other | Total    |
|---------------------------------------|----------------|-------------------------|-------------------|-----------------------|--------------|----------|
| Balance at beginning of period        | \$6,692        | \$ 4,344                | \$ 3,921          | \$ 595                | \$ 171       | \$15,723 |
| Additions: Provisions for loan losses | 172            | 351                     | (224 )            | (44 )                 | (30 )        | 225      |
| Deductions:                           |                |                         |                   |                       |              |          |
| Gross loan charge-offs                | —              | —                       | —                 | —                     | (56 )        | (56 )    |
| Recoveries                            | 5              | 30                      | 71                | 77                    | 77           | 260      |
| Net loan charge-offs                  | 5              | 30                      | 71                | 77                    | 21           | 204      |
| Balance at end of period              | \$6,869        | \$ 4,725                | \$ 3,768          | \$ 628                | \$ 162       | \$16,152 |

Note 3 — Loans and Allowance for Loan Losses – Continued

| (Dollars in thousands)                | Six Months Ended June 30, 2017 |                                   |                           |                             |                    |          |
|---------------------------------------|--------------------------------|-----------------------------------|---------------------------|-----------------------------|--------------------|----------|
|                                       | Real Estate Term               | Construction and Land Development | Commercial and Industrial | Residential and Home Equity | Consumer and Other | Total    |
| Balance at beginning of period        | \$6,770                        | \$ 5,449                          | \$ 3,718                  | \$ 617                      | \$ 161             | \$16,715 |
| Additions: Provisions for loan losses | 556                            | (451 )                            | 966                       | 84                          | (55 )              | 1,100    |
| Deductions:                           |                                |                                   |                           |                             |                    |          |
| Gross loan charge-offs                | (350 )                         | —                                 | (272 )                    | (338 )                      | (113 )             | (1,073 ) |
| Recoveries                            | 181                            | 79                                | 77                        | 140                         | 52                 | 529      |
| Net loan charge-offs                  | (169 )                         | 79                                | (195 )                    | (198 )                      | (61 )              | (544 )   |
| Balance at end of period              | \$7,157                        | \$ 5,077                          | \$ 4,489                  | \$ 503                      | \$ 45              | \$17,271 |

| (Dollars in thousands)                | Six Months Ended June 30, 2016 |                                   |                           |                             |                    |          |
|---------------------------------------|--------------------------------|-----------------------------------|---------------------------|-----------------------------|--------------------|----------|
|                                       | Real Estate Term               | Construction and Land Development | Commercial and Industrial | Residential and Home Equity | Consumer and Other | Total    |
| Balance at beginning of period        | \$6,783                        | \$ 3,984                          | \$ 3,941                  | \$ 603                      | \$ 246             | \$15,557 |
| Additions: Provisions for loan losses | 77                             | 695                               | (209 )                    | (56 )                       | (82 )              | 425      |
| Deductions:                           |                                |                                   |                           |                             |                    |          |
| Gross loan charge-offs                | —                              | —                                 | (72 )                     | —                           | (120 )             | (192 )   |
| Recoveries                            | 9                              | 46                                | 108                       | 81                          | 118                | 362      |
| Net loan charge-offs                  | 9                              | 46                                | 36                        | 81                          | (2 )               | 170      |
| Balance at end of period              | \$6,869                        | \$ 4,725                          | \$ 3,768                  | \$ 628                      | \$ 162             | \$16,152 |

Non-accrual loans are summarized as follows:

| (Dollars in thousands)                                  | June 30, 2017 | December 31, 2016 |
|---|---------------|-------------------|
| Non-accrual loans, not troubled debt restructured:      |               |                   |
| Real estate term  | \$4,089       | \$ 2,386          |
| Construction and land development                       | 826           | 378               |
| Commercial and industrial                               | 1,513         | 1,211             |
| Residential and home equity                             | 116           | 142               |
| Consumer and other                                      | —             | 14                |
| Total non-accrual loans, not troubled debt restructured | 6,544         | 4,131             |
| Troubled debt restructured loans, non-accrual:          |               |                   |
| Real estate term  | 663           | 808               |
| Construction and land development                       | 383           | 396               |

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|   |         |          |
|---|---------|----------|
| Commercial and industrial                           | —       | —        |
| Residential and home equity                         | —       | —        |
| Consumer and other                                  | —       | —        |
| Total troubled debt restructured loans, non-accrual | 1,046   | 1,204    |
| Total non-accrual loans                             | \$7,590 | \$ 5,335 |

Note 3 — Loans and Allowance for Loan Losses – Continued

Troubled debt restructured loans are summarized as follows:

|  | June<br>30,<br>2017 | December<br>31,<br>2016 |
|--|---------------------|-------------------------|
| (Dollars in thousands)                       |                     |                         |
| Accruing troubled debt restructured loans    | \$4,162             | \$ 5,572                |
| Non-accrual troubled debt restructured loans | 1,046               | 1,204                   |
| Total troubled debt restructured loans       | \$5,208             | \$ 6,776                |

A restructured loan is considered a troubled debt restructured loan (“TDR”), if the Company, for economic or legal reasons related to the debtor’s financial difficulties, grants a concession in terms or a below-market interest rate to the debtor that it would not otherwise consider. Each TDR loan is separately negotiated with the borrower and includes terms and conditions that reflect the borrower’s prospective ability to service the debt as modified.

Current and past due loans held for investment (accruing and non-accruing) are summarized as follows:

| (Dollars in thousands)            | June 30, 2017 |                              |                            |             | Total<br>Past<br>Due | Total<br>Loans |
|-----------------------------------|---------------|------------------------------|----------------------------|-------------|----------------------|----------------|
|                                   | Current       | 30-89<br>Days<br>Past<br>Due | 90+<br>Days<br>Past<br>Due | Non-accrual |                      |                |
| <b>Commercial real estate:</b>    |               |                              |                            |             |                      |                |
| Real estate term                  | \$639,004     | \$-                          | \$ —                       | \$ 4,752    | \$4,752              | \$643,756      |
| Construction and land development | 249,428       | 1,104                        | —                          | 1,209       | 2,313                | 251,741        |
| Total commercial real estate      | 888,432       | 1,104                        | —                          | 5,961       | 7,065                | 895,497        |
| Commercial and industrial         | 220,047       | 341                          | —                          | 1,513       | 1,854                | 221,901        |
| <b>Consumer:</b>                  |               |                              |                            |             |                      |                |
| Residential and home equity       | 73,602        | 73                           | —                          | 116         | 189                  | 73,791         |
| Consumer and other                | 14,567        | 348                          | 21                         | -           | 369                  | 14,936         |
| Total consumer                    | 88,169        | 421                          | 21                         | 116         | 558                  | 88,727         |
| Total gross loans                 | \$1,196,648   | \$1,866                      | \$ 21                      | \$ 7,590    | \$9,477              | \$1,206,125    |

| (Dollars in thousands)         | December 31, 2016 |                              |                            |             | Total<br>Past<br>Due | Total<br>Loans |
|--------------------------------|-------------------|------------------------------|----------------------------|-------------|----------------------|----------------|
|                                | Current           | 30-89<br>Days<br>Past<br>Due | 90+<br>Days<br>Past<br>Due | Non-accrual |                      |                |
| <b>Commercial real estate:</b> |                   |                              |                            |             |                      |                |
| Real estate term               | \$577,134         | \$1,701                      | \$ —                       | \$ 3,194    | \$4,895              | \$582,029      |

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|                                   |             |         |       |          |          |             |
|-----------------------------------|-------------|---------|-------|----------|----------|-------------|
| Construction and land development | 237,433     | 1,913   | —     | 774      | 2,687    | 240,120     |
| Total commercial real estate      | 814,567     | 3,614   | —     | 3,968    | 7,582    | 822,149     |
| Commercial and industrial         | 211,143     | 906     | —     | 1,211    | 2,117    | 213,260     |
| Consumer:                         |             |         |       |          |          |             |
| Residential and home equity       | 71,719      | 1,098   | —     | 142      | 1,240    | 72,959      |
| Consumer and other                | 15,168      | 474     | 22    | 14       | 510      | 15,678      |
| Total consumer                    | 86,887      | 1,572   | 22    | 156      | 1,750    | 88,637      |
| Total gross loans                 | \$1,112,597 | \$6,092 | \$ 22 | \$ 5,335 | \$11,449 | \$1,124,046 |
| Credit Quality Indicators:        |             |         |       |          |          |             |

In addition to past due and non-accrual criteria, the Company also analyzes loans using a loan grading system. Performance-based grading follows the Company's definitions of Pass, Special Mention, Substandard and Doubtful, which are consistent with published definitions of regulatory risk classifications.

Note 3 — Loans and Allowance for Loan Losses – Continued

Definitions of Pass, Special Mention, Substandard and Doubtful are summarized as follows:

**Pass:** A Pass asset is higher quality and does not fit any of the other categories described below. The likelihood of loss is considered remote.

**Special Mention:** A Special Mention asset has potential weaknesses that may be temporary or, if left uncorrected, may result in a loss. While concerns exist, the Company is currently protected and loss is considered unlikely and not imminent.

**Substandard:** A Substandard asset is inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified have well defined weaknesses and are characterized by the distinct possibility that the Company may sustain some loss if deficiencies are not corrected.

**Doubtful:** A Doubtful asset has all the weaknesses inherent in a Substandard asset with the added characteristics that the weaknesses make collection or liquidation in full highly questionable.

For Consumer loans, the Company generally assigns internal risk grades similar to those described above based on payment performance.

Outstanding loan balances (accruing and non-accruing) categorized by these credit quality indicators are summarized as follows:

| (Dollars in thousands)            | June 30, 2017 |                    |                                |                |                    |
|-----------------------------------|---------------|--------------------|--------------------------------|----------------|--------------------|
|                                   | Pass          | Special<br>Mention | Substandard<br>and<br>Doubtful | Total<br>Loans | Total<br>Allowance |
| <b>Commercial real estate:</b>    |               |                    |                                |                |                    |
| Real estate term                  | \$622,611     | \$13,871           | \$ 7,274                       | \$643,756      | \$ 7,157           |
| Construction and land development | 247,157       | 2,081              | 2,503                          | 251,741        | 5,077              |
| Total commercial real estate      | 869,768       | 15,952             | 9,777                          | 895,497        | 12,234             |
| Commercial and industrial         | 212,211       | 4,938              | 4,752                          | 221,901        | 4,489              |
| <b>Consumer loans:</b>            |               |                    |                                |                |                    |
| Residential and home equity       | 71,041        | 1,717              | 1,033                          | 73,791         | 503                |
| Consumer and other                | 14,822        | —                  | 114                            | 14,936         | 45                 |
| Total consumer                    | 85,863        | 1,717              | 1,147                          | 88,727         | 548                |
| Total                             | \$1,167,842   | \$22,607           | \$ 15,676                      | \$1,206,125    | \$ 17,271          |

| (Dollars in thousands)         | December 31, 2016 |                    |                                |                |                    |
|--------------------------------|-------------------|--------------------|--------------------------------|----------------|--------------------|
|                                | Pass              | Special<br>Mention | Substandard<br>and<br>Doubtful | Total<br>Loans | Total<br>Allowance |
| <b>Commercial real estate:</b> |                   |                    |                                |                |                    |



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|                                   |             |          |           |             |           |
|-----------------------------------|-------------|----------|-----------|-------------|-----------|
| Real estate term                  | \$565,550   | \$10,609 | \$ 5,870  | \$582,029   | \$ 6,770  |
| Construction and land development | 234,359     | 2,222    | 3,539     | 240,120     | 5,449     |
| Total commercial real estate      | 799,909     | 12,831   | 9,409     | 822,149     | 12,219    |
| Commercial and industrial         | 205,933     | 2,266    | 5,061     | 213,260     | 3,718     |
| Consumer loans:                   |             |          |           |             |           |
| Residential and home equity       | 69,287      | 1,869    | 1,803     | 72,959      | 617       |
| Consumer and other                | 15,542      | —        | 136       | 15,678      | 161       |
| Total consumer                    | 84,829      | 1,869    | 1,939     | 88,637      | 778       |
| Total                             | \$1,090,671 | \$16,966 | \$ 16,409 | \$1,124,046 | \$ 16,715 |

Note 3 — Loans and Allowance for Loan Losses – Continued

The ALLL and outstanding loan balances reviewed according to the Company's impairment method are summarized as follows:

| (Dollars in thousands)                | June 30, 2017    |                                   |                           |                             |                    |                     |
|---------------------------------------|------------------|-----------------------------------|---------------------------|-----------------------------|--------------------|---------------------|
|                                       | Real Estate Term | Construction and Land Development | Commercial and Industrial | Residential and Home Equity | Consumer and Other | Total               |
| <b>Allowance for loan losses:</b>     |                  |                                   |                           |                             |                    |                     |
| Individually evaluated for impairment | \$61             | \$ 67                             | \$ 528                    | \$ 72                       | \$ —               | \$728               |
| Collectively evaluated for impairment | 7,096            | 5,010                             | 3,961                     | 431                         | 45                 | 16,543              |
| <b>Total</b>                          | <b>\$7,157</b>   | <b>\$ 5,077</b>                   | <b>\$ 4,489</b>           | <b>\$ 503</b>               | <b>\$ 45</b>       | <b>\$17,271</b>     |
| <b>Outstanding loan balances:</b>     |                  |                                   |                           |                             |                    |                     |
| Individually evaluated for impairment | \$4,854          | \$ 2,327                          | \$ 2,684                  | \$ 634                      | \$ —               | \$10,499            |
| Collectively evaluated for impairment | 638,902          | 249,414                           | 219,217                   | 73,157                      | 14,936             | 1,195,626           |
| <b>Total gross loans</b>              | <b>\$643,756</b> | <b>\$ 251,741</b>                 | <b>\$ 221,901</b>         | <b>\$ 73,791</b>            | <b>\$ 14,936</b>   | <b>\$ 1,206,125</b> |

| (Dollars in thousands)                | December 31, 2016 |                                   |                           |                             |                    |                     |
|---------------------------------------|-------------------|-----------------------------------|---------------------------|-----------------------------|--------------------|---------------------|
|                                       | Real Estate Term  | Construction and Land Development | Commercial and Industrial | Residential and Home Equity | Consumer and Other | Total               |
| <b>Allowance for loan losses:</b>     |                   |                                   |                           |                             |                    |                     |
| Individually evaluated for impairment | \$189             | \$ 67                             | \$ 323                    | \$ 75                       | \$ —               | \$654               |
| Collectively evaluated for impairment | 6,581             | 5,382                             | 3,395                     | 542                         | 161                | 16,061              |
| <b>Total</b>                          | <b>\$6,770</b>    | <b>\$ 5,449</b>                   | <b>\$ 3,718</b>           | <b>\$ 617</b>               | <b>\$ 161</b>      | <b>\$16,715</b>     |
| <b>Outstanding loan balances:</b>     |                   |                                   |                           |                             |                    |                     |
| Individually evaluated for impairment | \$5,778           | \$ 2,995                          | \$ 6,045                  | \$ 1,476                    | \$ —               | \$16,294            |
| Collectively evaluated for impairment | 576,251           | 237,125                           | 207,215                   | 71,483                      | 15,678             | 1,107,752           |
| <b>Total gross loans</b>              | <b>\$582,029</b>  | <b>\$ 240,120</b>                 | <b>\$ 213,260</b>         | <b>\$ 72,959</b>            | <b>\$ 15,678</b>   | <b>\$ 1,124,046</b> |

Information on impaired loans is summarized as follows:

| June 30, 2017    |         |      |                     |         |
|------------------|---------|------|---------------------|---------|
| Unpaid Principal | With No | With | Recorded Investment |         |
|                  |         |      | Total Recorded      | Related |

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| (Dollars in thousands)            | Balance  | Allowance | Allowance | Investment | Allowance |
|-----------------------------------|----------|-----------|-----------|------------|-----------|
| <b>Commercial real estate:</b>    |          |           |           |            |           |
| Real estate term                  | \$4,940  | \$3,291   | \$ 1,563  | \$ 4,854   | \$ 61     |
| Construction and land development | 3,280    | 2,123     | 204       | 2,327      | 67        |
| Total commercial real estate      | 8,220    | 5,414     | 1,767     | 7,181      | 128       |
| Commercial and industrial         | 3,477    | 940       | 1,744     | 2,684      | 528       |
| <b>Consumer loans:</b>            |          |           |           |            |           |
| Residential and home equity       | 634      | 232       | 402       | 634        | 72        |
| Consumer and other                | —        | —         | —         | —          | —         |
| Total consumer                    | 634      | 232       | 402       | 634        | 72        |
| Total                             | \$12,331 | \$6,586   | \$ 3,913  | \$ 10,499  | \$ 728    |

Note 3 — Loans and Allowance for Loan Losses – Continued

| (Dollars in thousands)            | December 31, 2016        |                                       |                                    |                           |                   |
|-----------------------------------|--------------------------|---------------------------------------|------------------------------------|---------------------------|-------------------|
|                                   | Unpaid Principal Balance | Recorded Investment With No Allowance | Recorded Investment With Allowance | Total Recorded Investment | Related Allowance |
| <b>Commercial real estate:</b>    |                          |                                       |                                    |                           |                   |
| Real estate term                  | \$5,864                  | \$2,979                               | \$2,799                            | \$5,778                   | \$189             |
| Construction and land development | 3,949                    | 2,790                                 | 205                                | 2,995                     | 67                |
| Total commercial real estate      | 9,813                    | 5,769                                 | 3,004                              | 8,773                     | 256               |
| Commercial and industrial         | 6,937                    | 4,458                                 | 1,587                              | 6,045                     | 323               |
| <b>Consumer loans:</b>            |                          |                                       |                                    |                           |                   |
| Residential and home equity       | 1,476                    | 1,071                                 | 405                                | 1,476                     | 75                |
| Consumer and other                | —                        | —                                     | —                                  | —                         | —                 |
| Total consumer                    | 1,476                    | 1,071                                 | 405                                | 1,476                     | 75                |
| Total                             | \$18,226                 | \$11,298                              | \$4,996                            | \$16,294                  | \$654             |

The interest income recognized on impaired loans was as follows:

| (Dollars in thousands)            | Three Months Ended          |                              |                             |                              |
|-----------------------------------|-----------------------------|------------------------------|-----------------------------|------------------------------|
|                                   | June 30, 2017               |                              | June 30, 2016               |                              |
|                                   | Average Recorded Investment | Average Interest Recognition | Average Recorded Investment | Average Interest Recognition |
| <b>Commercial real estate:</b>    |                             |                              |                             |                              |
| Real estate term                  | \$4,734                     | \$6                          | \$8,416                     | \$74                         |
| Construction and land development | 2,872                       | 32                           | 3,767                       | 47                           |
| Total commercial real estate      | 7,606                       | 38                           | 12,183                      | 121                          |
| Commercial and industrial         | 4,280                       | 36                           | 7,934                       | 97                           |
| <b>Consumer loans:</b>            |                             |                              |                             |                              |
| Residential and home equity       | 850                         | 10                           | 1,794                       | 12                           |
| Consumer and other                | —                           | —                            | 15                          | —                            |
| Total consumer                    | 850                         | 10                           | 1,809                       | 12                           |
| Total                             | \$12,736                    | \$84                         | \$21,926                    | \$230                        |

| Six Months Ended             |                              |
|------------------------------|------------------------------|
| June 30, 2017                | June 30, 2016                |
| Average Recorded Investment  | Average Recorded Investment  |
| Average Interest Recognition | Average Interest Recognition |

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| (Dollars in thousands)            | Investmen | Recognition | Investmen | Recognition |
|-----------------------------------|-----------|-------------|-----------|-------------|
| Commercial real estate:           |           |             |           |             |
| Real estate term                  | \$5,316   | \$ 36       | \$9,106   | \$ 153      |
| Construction and land development | 2,660     | 63          | 3,865     | 102         |
| Total commercial real estate      | 7,976     | 99          | 12,971    | 255         |
| Commercial and industrial         | 4,365     | 90          | 7,243     | 185         |
| Consumer loans:                   |           |             |           |             |
| Residential and home equity       | 1,055     | 23          | 1,980     | 34          |
| Consumer and other                | —         | —           | 15        | —           |
| Total consumer                    | 1,055     | 23          | 1,995     | 34          |
| Total                             | \$13,396  | \$ 212      | \$22,209  | \$ 474      |

Note 3 — Loans and Allowance for Loan Losses – Concluded

Loans and Deposits to affiliates — The Company has entered into loan transactions with certain directors, affiliated companies and executive committee members (“affiliates”). Such transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features. Total outstanding loans with affiliates were approximately \$3,327,000 and \$330,000 as of June 30, 2017 and December 31, 2016, respectively. Available lines of credit for loans and credit cards to affiliates were approximately \$509,000 as of June 30, 2017. Deposits from affiliates were \$7.6 million and \$7.8 million as of June 30, 2017 and December 31, 2016, respectively.

Note 4 — Commitments and Contingencies

Litigation contingencies— The Company is involved in various claims, legal actions and complaints which arise in the ordinary course of business. In the Company’s opinion, all such matters are adequately covered by insurance, are without merit or are of such kind, or involve such amounts, that unfavorable disposition would not have a material adverse effect on the financial condition or results of operations of the Company.

Commitments to extend credit — In the normal course of business, the Company has outstanding commitments and contingent liabilities, such as commitments to extend credit and unused credit card lines, which are not included in the accompanying consolidated financial statements. The Company’s exposure to credit loss in the event of non-performance by other parties to the financial instruments for commitments to extend credit and unused credit card lines is represented by the contractual or notional amount of those instruments. The Company uses the same credit policies in making such commitments as it does for instruments that are included in the consolidated balance sheets.

Contractual amounts of off-balance sheet financial instruments were as follows:

| (Dollars in thousands)                            | June 30,<br>2017 | December<br>31,<br>2016 |
|---|------------------|-------------------------|
| Commitments to extend credit, including unsecured |                  |                         |
| commitments of \$12,185 and \$11,230 as of        |                  |                         |
| June 30, 2017 and December 31, 2016,              |                  |                         |
| respectively                                      | \$516,291        | \$445,645               |
| Stand-by letters of credit and bond commitments,  | 29,233           | 29,332                  |

including unsecured commitments of \$566 and

\$660 as of June 30, 2017 and December 31,

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|   |        |        |
|---|--------|--------|
| 2016, respectively                      |        |        |
| Unused credit card lines, all unsecured | 25,337 | 25,803 |

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments to extend credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Company, is based on management's credit evaluation of the customer.

Unused credit card lines are commitments for possible future extensions of credit to existing customers. These lines of credit are uncollateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Company is committed.

Note 5 — Fair Value

Fair value measurements — Fair value represents the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. To measure fair value, GAAP has established a hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs. This hierarchy uses three levels of inputs to measure the fair value of assets and liabilities as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities.

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Level 2 Observable inputs other than Level 1 including quoted prices for similar assets or liabilities, quoted prices in less active markets, or other observable inputs that can be corroborated by observable market data.

Level 3 Unobservable inputs supported by little or no market activity for financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The following is a description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation methodology:

Investment securities, available-for-sale — Where quoted prices are available in an active market, securities are classified within Level 1 of the hierarchy. Level 1 includes securities that have quoted prices in an active market for identical assets. If quoted market prices are not available, then fair values are estimated using pricing models, quoted prices of securities with similar characteristics or discounted cash flows, and accordingly, are classified as Level 2 or 3. The Company has categorized its available-for-sale investment securities as Level 1 or 2.

Impaired loans and other real estate owned — Fair value applies to loans and other real estate owned measured for impairment. Impaired loans are measured at the fair value of the loan's collateral (if collateral dependent) or net present value of future cash flows (if not collateral dependent). Fair value of the loan's collateral is determined by appraisals or independent valuation which is then adjusted for the cost related to liquidation of the collateral. The Company has categorized its impaired loans and other real estate owned as Level 2.

Assets measured at fair value are summarized as follows:

| (Dollars in thousands)                   | Level<br>1 | Level 2   | Level<br>3 | Total     |
|--|------------|-----------|------------|-----------|
| As of June 30, 2017                      |            |           |            |           |
| Fair valued on a recurring basis:        |            |           |            |           |
| Investment securities available-for-sale | \$ 1,002   | \$324,170 | \$ —       | \$325,172 |
| Fair valued on a non-recurring basis:    |            |           |            |           |
| Impaired loans                           | —          | 3,185     | —          | 3,185     |



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As of December 31, 2016

Fair valued on a recurring basis:

|  |          |            |      |            |
|--|----------|------------|------|------------|
| Investment securities available-for-sale | \$ 1,008 | \$ 334,601 | \$ — | \$ 335,609 |
|--|----------|------------|------|------------|

Fair valued on a non-recurring basis:

|                |   |       |   |       |
|----------------|---|-------|---|-------|
| Impaired loans | — | 4,342 | — | 4,342 |
|----------------|---|-------|---|-------|

## Note 5 — Fair Value - Continued

Fair value of financial instruments — The following table summarizes carrying amounts, estimated fair values and assumptions used to estimate fair values of financial instruments:

| (Dollars in thousands)        | Carrying<br>Value | Estimated<br>Fair Value |
|-------------------------------|-------------------|-------------------------|
| As of June 30, 2017           |                   |                         |
| Financial Assets:             |                   |                         |
| Net loans held for investment | \$1,184,120       | \$1,184,297             |
| Financial Liabilities:        |                   |                         |
| Interest bearing deposits     | 995,064           | 995,098                 |
| As of December 31, 2016       |                   |                         |
| Financial Assets:             |                   |                         |
| Net loans held for investment | \$1,103,162       | \$1,101,890             |
| Financial Liabilities:        |                   |                         |
| Interest bearing deposits     | 981,974           | 982,380                 |

The above summary excludes financial assets and liabilities for which carrying value approximates fair value. For financial assets, these include cash and cash equivalents, held-to-maturity securities (see Note 2), loans held for sale, bank-owned life insurance, accrued interest receivable, and FHLB stock. For financial liabilities, these include non-interest bearing deposits, short-term borrowings, and accrued interest payable. Also excluded from the summary are financial instruments recorded at fair value on a recurring basis, as previously described.

Fair values of off-balance sheet commitments such as lending commitments, standby letters of credit and guarantees are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of the fees as of June 30, 2017 and December 31, 2016 were insignificant.

The following methods and assumptions were used to estimate the fair value of financial instruments:

Net loans held for investment — The fair value is estimated by discounting the future cash flows and estimated prepayments using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining term. Some loan types were valued at carrying value because of their floating rate or expected maturity characteristics.

Interest bearing deposits — The fair value of interest bearing deposits is estimated by discounting the estimated future cash flows using the rates currently offered for deposits with similar remaining maturities.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. Fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in the above methodologies and assumptions could significantly affect the estimates. Further, certain financial instruments and all non-financial instruments are excluded from the applicable disclosure requirements. Therefore, the fair value amounts shown in the table do not, by themselves, represent the underlying value of the Company as a whole.

Note 6 — Income Taxes

Income tax expense was \$3.6 million and \$3.4 million for the three months ended June 30, 2017 and 2016, respectively. The Company's effective tax rate for the second quarter of 2017 was 35.6% compared with 37.9% in the second quarter of 2016. The tax rate in the second quarter of 2017 is lower than the same quarter in 2016 due primarily to adjustments in the expected recoverability of certain tax credits.

Income tax expense was \$6.3 million and \$6.3 million for the six months ended June 30, 2017 and 2016, respectively. The Company's effective tax rate was 32.7% and 36.8% for the six months ended June 30, 2017 and 2016, respectively. The tax rate in 2017 is lower than 2016 due primarily to tax-deductible stock compensation expense and the reversal of a liability related to an unrecognized tax benefit totaling, approximately \$600,000 in taxable benefits.

Note 7 — Regulatory Capital Matters

The consolidated Tier 1 Leverage ratio increased from 13.71% at December 31, 2016 to 14.15% as of June 30, 2017. Federal Reserve Board Regulations require maintenance of certain minimum reserve balances based on certain average deposits which as of June 30, 2017 and December 31, 2016 were \$9.9 million and \$9.1 million, respectively. The Company's Board of Directors may declare a cash or stock dividend out of retained earnings provided the regulatory minimum capital ratios are met. The Company plans to maintain capital ratios that meet the well-capitalized standards per the regulations and, therefore, plans to limit dividends to amounts that are appropriate to maintain those well-capitalized regulatory capital ratios.

Note 8 — Incentive Share-Based Plan and Other Employee Benefits

In June 2014, the Board of Directors ("Board") and shareholders of the Company approved a share-based incentive plan ("the Plan"). The Plan provides for various share-based incentive awards including incentive share-based options, non-qualified share-based options, restricted shares, and stock appreciation rights to be granted to officers, directors and other key employees. The maximum aggregate number of shares that may be issued under the Plan is 800,000 common shares. The share-based awards are granted to participants under the Plan at a price not less than the fair value on the date of grant and for terms of up to ten years. The Plan also allows for granting of share-based awards to directors and consultants who are not employees of the Company.

During the six months ended June 30, 2017, the Company granted options for the purchase of 769 common shares, which have a weighted average exercise price of \$26.26 per share and a weighted average fair value as of the date of grant of \$4.867 per share. Additionally, the Company granted 104 restricted stock units ("RSU") at a weighted-average fair value of \$25.00 per unit. The options and RSU's generally vest over periods from one to three years. The Company recorded share-based compensation expense of \$218,000 and \$252,000 for the six months ended June 30, 2017 and 2016, respectively.

Note 9 — Announced Transactions

Town & Country Bank:

On May 31, 2017, the Company entered into a definitive agreement to acquire Town & Country Bank Inc. ("Town & Country Bank"), a community based bank in St. George Utah, whereby Town & Country Bank will be merged with and into PIB, a wholly owned subsidiary of PUB. Under the terms of the agreement, each outstanding share will receive \$4.28 in cash and 0.2978 PUB common shares. Based on the closing price of \$25.55 for PUB shares on May 30, 2017, the transaction would result in an aggregate value of \$20.9 million or \$11.89 per fully diluted Town & Country Bank common share. \$1.5 million of the cash to be paid to shareholders will be held in escrow for eighteen months after closing pending the resolution of certain contingencies. Town & Country Bank shareholders may also receive additional cash consideration at closing subject to certain closing conditions.

The transaction was unanimously approved by the boards of directors of both companies. The transaction is expected to close in the fourth quarter of 2017 subject to Town & Country Bank's shareholder approval, required regulatory approval and the satisfaction of other customary closing conditions. The Company's primary reasons for the

transaction are to solidify its market share in the St. George, Utah market, expand its customer base to enhance total revenues and leverage operating costs through economies of scale.

Town & Country Bank currently operates one branch in St. George and one loan production office in Sandy, UT. The Town & Country Bank office and PIB's Bank of American Fork branch in St. George are expected to be consolidated in January 2018. Upon consolidation, the combined division will operate under the name "People's Town & Country Bank." Bank of American Fork branches in other areas will not be affected by this St. George-area name change. Town & Country Bank's Sandy loan production office is expected to be consolidated with the current Bank of American Fork Sandy branch and will operate under the name Bank of American Fork. This merger is part of a larger bank-wide strategy to establish a community-banking network with local names throughout Utah and potentially in adjoining states. As of March 31, 2017, Town & Country Bank had total assets of \$135.1 million, gross loans of \$97.3 million and total deposits of \$119.7 million.

Banner Bank Utah Branches:

On July 27, 2017, the Company signed a purchase and assumption agreement to acquire approximately \$266 million in loans and seven Utah branch locations with approximately \$159 million in deposits from Banner Corporation's banking subsidiary, Banner Bank. PIB will operate the branches under the name of Bank of American Fork, a division of PIB. The seven branches are located in Salt Lake City, Provo, South Jordan, Woods Cross, Orem, Salem, and Springville. The Woods Cross and Orem branches will be consolidated into the existing Bank of American Fork Bountiful and Orem branches, respectively. The transaction is expected to close in the fourth quarter of 2017 and is subject to certain closing conditions, including receipt of regulatory approval.

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

The following discussion is intended to provide a more comprehensive review of People's Utah Bancorp's operating results and financial condition than can be obtained from reading the Unaudited Consolidated Financial Statements alone. The discussion should be read in conjunction with the Unaudited Consolidated Financial Statements and the notes thereto included in "Part I. Item 1. Financial Statements."

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q may contain certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements reflect our current views and are not historical facts. These statements can generally be identified by use of phrases such as "believe," "expect," "will," "seek," "should," "anticipate," "estimate," "intend," "plan," "target," "project," "commit" or other words of similar import. Similarly, statements that describe our future financial condition, results of operations, objectives, strategies, plans, goals or future performance and business are also forward-looking statements. These forward-looking statements include but are not limited to, (i) the expected closing dates of the acquisitions of Town & Country Bank and the seven Utah branches of Banner bank, and (ii) the impact on our business of these acquisitions, including, without limitation, the impact on the average equity, average assets and liquidity ratios after the closing of the acquisitions. Statements that project future financial conditions, results of operations and shareholder value are not guarantees of performance and many of the factors that will determine these results and values are beyond our ability to control or predict. For those statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. These are forward-looking statements and involve known and unknown risks, uncertainties and other factors, including, but not limited to, those described in the "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" sections in this report and our Annual Report on Form 10-K for the year ended December 31, 2016 ("Form 10-K"), and other parts of this report that could cause our actual results to differ materially from those anticipated in these forward-looking statements. The following is a non-exclusive list of factors which could cause our actual results to differ materially from our forward-looking statements in this prospectus:

- changes in general economic conditions, either nationally or in our local market;
- inflation, interest rates, securities market volatility and monetary fluctuations;
- increases in competitive pressures among financial institutions and businesses offering similar products and services;
- higher defaults on our loan portfolio than we expect;
  - changes in management's estimate of the adequacy of the allowance for loan losses;

risks associated with our growth and expansion strategy and related costs;  
failure to successfully integrate acquisitions and mergers that are pending  
increased lending risks associated with our high concentration of real estate loans;  
ability to successfully grow our business in Utah and neighboring states;  
legislative or regulatory changes or changes in accounting principles, policies or guidelines;  
technological changes;  
regulatory or judicial proceedings; and  
other factors and risks including those described under “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in this report and our Annual Report on Form 10-K for the year ended December 31, 2016.

Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, expected, projected, intended, committed or believed.

Please take into account that forward-looking statements speak only as of the date of this Form 10-Q. We do not undertake any obligation to release publicly our revisions to such forward-looking statements to reflect events or circumstances after the date of this Form 10-Q.

## Overview

We are a bank holding company, formed in 1998 and headquartered in American Fork, Utah, which is located on the I-15 corridor between the cities of Salt Lake City and Provo. We have four divisions in our wholly-owned subsidiary, People's Intermountain Bank ("PIB" or the "Bank"). We have 20 banking locations operating through two banking divisions, dba, BAF and LSB, which began offering banking services in 1913 and 1905, respectively. Our third division is GrowthFunding Equipment Finance, an equipment leasing operation which originates direct equipment leasing products to businesses nationwide and to our banking customers. Our fourth division is People's Intermountain Bank Mortgage, a mortgage operation which originates mortgages. We provide full-service retail banking in many of the leading population centers in the state of Utah, including a wide range of banking and related services to locally-owned businesses, professional firms, real estate developers, residential home builders, high net-worth individuals, investors and other customers. Our primary customers are small and medium-sized businesses that require highly personalized commercial banking products and services.

We believe our growth is a result of our ability to attract and retain high-quality associates, add branches in attractive markets and provide good customer service, as well as due to the expansion of our construction, land acquisition and development and commercial and industrial lending. The primary source of funding for our asset growth has been the generation of core deposits, which we accomplish through a combination of competitive pricing for local deposits coupled with expansion of our branch system. We have opened new branches during the year in Preston, Idaho, and Bountiful, Utah.

Our results of operations are largely dependent on net interest income. Net interest income is the difference between interest income we earn on interest earning assets, which are comprised of loans, investment securities and short-term investments and the interest we pay on our interest-bearing liabilities, which are primarily deposits, and, to a lesser extent, other borrowings. Deposits are our primary source of funding. Management strives to match the re-pricing characteristics of the interest earning assets and interest bearing liabilities to protect net interest income from changes in market interest rates and changes in the shape of the yield curve.

We measure our performance by calculating our net interest margin, return on average assets, and return on average equity. Net interest margin is calculated by dividing net interest income, which is the difference between interest income on interest earning assets and interest expense on interest bearing liabilities, by average interest earning assets. Net interest income is our largest source of revenue. Interest rate fluctuations, as well as changes in the amount and type of earning assets and liabilities, combine to affect net interest income. We also measure our performance by our efficiency ratio, which is calculated by dividing non-interest expense less merger-related costs, if applicable, by the sum of net interest income and non-interest income.

## Announced Transactions

Town & Country Bank:



On May 31, 2017, the Company entered into a definitive agreement to acquire Town & Country Bank, Inc. (“Town & Country Bank”), a community based bank in St. George Utah, whereby Town & Country Bank will be merged with and into PIB, a wholly owned subsidiary of PUB. Under the terms of the agreement, each outstanding share will receive \$4.28 in cash and 0.2978 PUB common shares. Based on the closing price of \$25.55 for PUB shares on May 30, 2017, the transaction would result in an aggregate value of \$20.9 million or \$11.89 per fully diluted Town & Country Bank common share. \$1.5 million of the cash to be paid to shareholders will be held in escrow for eighteen months after closing pending the resolution of certain contingencies. Town & Country Bank shareholders may also receive additional cash consideration at closing subject to certain closing conditions.

The transaction was unanimously approved by the boards of directors of both companies. The transaction is expected to close in the fourth quarter of 2017 subject to Town & Country Bank’s shareholder approval, required regulatory approval and the satisfaction of other customary closing conditions. The Company’s primary reasons for the transaction are to solidify its market share in the St. George, Utah market, expand its customer base to enhance total revenues and leverage operating costs through economies of scale.

Town & Country Bank currently operates one branch in St. George and one loan production office in Sandy, UT. The Town & Country Bank office and PIB's Bank of American Fork branch in St. George are expected to be consolidated in January 2018. Upon consolidation, the combined division will operate under the name "People's Town & Country Bank". Bank of American Fork branches in other areas will not be affected by this St. George-area name change. Town & Country Bank's Sandy loan production office is expected to be consolidated with the current Bank of American Fork Sandy branch and will operate under the name Bank of American Fork. This is part of a larger bank-wide strategy to establish a community-banking network with local names throughout Utah and potentially in adjoining states. As of March 31, 2017, Town & Country Bank had total assets of \$135.1 million, gross loans of \$97.3 million and total deposits of \$119.7 million.

**Banner Bank Utah Branches:**

On July 27, 2017, the Company signed a purchase and assumption agreement to acquire approximately \$266 million in loans and seven Utah branch locations with approximately \$159 million in deposits from Banner Corporation's banking subsidiary, Banner Bank. PIB will operate the branches under the name of Bank of American Fork, a division of PIB. The seven branches are located in Salt Lake City, Provo, South Jordan, Woods Cross, Orem, Salem, and Springville. The Woods Cross and Orem branches are planned to be consolidated into the existing Bank of American Fork Bountiful and Orem branches, respectively. The transaction is expected to close in the fourth quarter of 2017 and is subject to certain closing conditions, including receipt of regulatory approval.

A copy of the purchase and assumption agreement is attached as Exhibit 2.1 and incorporated herein by reference. The foregoing description does not purport to be complete and is qualified in its entirety by reference to the full text of the purchase and assumption agreement attached as Exhibit 2.1.

Key Factors in Evaluating Our Financial Condition and Results of Operations

As a bank holding company, we focus on a number of key factors in evaluating our financial condition and results of operations including:

- Return on average equity;
  - Return on average assets;
- Asset quality;
- Asset growth;
- Capital and liquidity;
- Net interest margin; and
- Operating efficiency.

The chart below shows these key financial measures:

| (Dollars in thousands except per share amounts) | Six Months Ended |               |   |   |
|---|------------------|---------------|---|---|
|   | June 30, 2017    | June 30, 2016 |   |   |
| Net income                                      | \$13,015         | \$10,820      |   |   |
| Basic earnings per share                        | 0.73             | 0.61          |   |   |
| Diluted earnings per share                      | 0.71             | 0.60          |   |   |
| Total assets                                    | 1,718,375        | 1,583,016     |   |   |
| Total loans held for investment, net            | 1,184,120        | 1,079,676     |   |   |
| Total deposits                                  | 1,461,052        | 1,346,363     |   |   |
| Net interest margin                             | 4.63             | 4.63          | % | % |
| Efficiency ratio                                | 54.44            | 58.32         | % | % |
| Return on average assets                        | 1.56             | 1.40          | % | % |
| Return on average equity                        | 11.14            | 10.07         | % | % |
| Average equity to average assets                | 14.00            | 13.89         | % | % |
| Non-performing assets to total assets           | 0.47             | 0.38          | % | % |
| Liquidity ratio <sup>(1)</sup>                  | 28.77            | 28.81         | % | % |
| Dividend Payout Ratio <sup>(2)</sup>            | 22.03            | 22.87         | % | % |

(1) The liquidity ratio is the sum of cash equivalents and investment securities, less investment securities pledged as collateral against short-term borrowings, all divided by total liabilities. Pledged investment securities were \$34.6 million and \$36.1 million at June 30, 2017 and 2016, respectively.

(2) The dividend payout ratio is dividends paid divided by net income for the period.

**Return on Average Equity.** We measure the return to our shareholders through a return on average equity, or ROE, calculation. Our net income for the six months ended June 30, 2017 increased 20.3% to \$13.0 million from \$10.8 million for the comparable period in 2016. Net income for the six months ended June 30, 2017 increased primarily due to an increase in interest income due to loan growth, an increase in non-interest income offset by an increase in non-interest expenses. Basic earnings per share, or EPS, was \$0.73 for the six months ended June 30, 2017 compared to \$0.61 for the comparable period in 2016. Diluted EPS was \$0.71 per share for the six months ended June 30, 2017 compared to \$0.60 per share for the comparable period in 2016. ROE increased to 11.14% for the six months ended June 30, 2017 compared to 10.07% for the comparable period in 2016, primarily from the 20.3% increase in net income.

**Return on Average Assets.** We measure asset utilization through a return on average assets, or ROA, calculation. For the six months ended June 30, 2017 our ROA increased to 1.56% compared to 1.40% for the six months ended June 30, 2016. The increase in ROA is a result of improved operating results as discussed throughout this Management's

Discussion & Analysis.

Asset Quality. Since the majority of our performing assets are loans, we measure asset quality in terms of non-performing assets as a percentage of total assets. This measurement is used in determining asset quality and its potential effect on future earnings. Non-performing assets as a percentage of total assets were 0.47% as of June 30, 2017 compared to 0.38% as of June 30, 2016. Non-performing assets are loans that are 90 days or more past due or have been placed on nonaccrual status, or are other real estate owned, or OREO.

**Asset Growth.** Revenue growth and EPS are directly related to earning assets growth. In descending order, our earning assets are loans, investments (including federal funds) and interest earning deposit balances. As of June 30, 2017, compared to June 30, 2016, total assets grew 8.6%, total net loans increased by 9.2%, and investment securities increased by 17.7%. Loan growth in 2017 came primarily from the increased level of real estate, construction, acquisition and land development lending activities.

**Capital and Liquidity.** Maintaining appropriate capital and liquidity levels is imperative for us to continue our strong growth levels. We have been successful in maintaining capital levels well above the minimum regulatory requirements, which we believe has enabled our growth strategy. In 2015, we raised approximately \$34.9 million in new capital from our IPO. We plan to utilize the additional capital for expansion purposes, both organic and through acquisition, and for general corporate purposes. We have two pending acquisitions: 1) Town & Country Bank, Inc. in St. George, Utah, and 2) approximately \$260 million in loans with approximately \$180 million in low-cost deposits of Banner Bank's seven Utah-based bank branches and an operations center. Both transactions are subject to customary closing conditions and regulatory approval. Our average equity to average assets ratio as of June 30, 2017 was 14.00% compared to 13.89% as of June 30, 2016. The average equity, average assets and liquidity ratios will likely decline after closing the pending acquisitions. We monitor liquidity levels to ensure we have adequate sources available to fund our loan growth and to accommodate daily operations. The key measure we use to monitor liquidity is our liquidity ratio which is calculated as cash and cash equivalents plus unpledged investment securities divided by total liabilities. Our liquidity ratio was 28.77% as of June 30, 2017, compared to 28.81% as of June 30, 2016.

**Net Interest Margin.** Net interest margin is a metric that allows us to gauge our loan pricing and funding cost relationship. For the six months ended June 30, 2017 and 2016, our net interest margin was 4.63% for both periods.

**Operating Efficiency.** Operating efficiency is the measure of how much it costs us to generate each dollar of revenue. A lower percentage indicates a better operating efficiency. Our efficiency ratio is calculated as the sum of non-interest expense less merger and acquisition related expenses, if applicable, divided by the sum of net interest income and non-interest income and was 54.44% for the six months ended June 30, 2017 as compared to 58.32% for the six months ended June 30, 2016. The improvement in the efficiency ratio is the result of operating efficiencies as discussed throughout this Management's Discussion & Analysis.

## Results of Operations

Factors that determine the level of net income include the volume of earning assets and interest bearing liabilities, yields earned and rates paid, fee income, non-interest expense, the level of non-performing loans and other non-earning assets, and the amount of non-interest bearing liabilities supporting earning assets. Non-interest income primarily includes service charges and other fees on deposits, and mortgage banking income. Non-interest expense consists primarily of employee compensation and benefits, occupancy, equipment and depreciation expense, and other operating expenses.

**Average Balance and Yields.** The following tables set forth a summary of average balances with corresponding interest income and interest expense as well as average yield, cost and net interest margin information for the periods presented. Average balances are derived from daily balances. Average non-accrual loans are derived from quarterly balances and are included as non-interest earning assets for purposes of these tables.

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| (Dollars in thousands, except footnotes)                        | Three Months Ended<br>June 30, 2017 |                                |                           | June 30, 2016      |                                |                           |
|---|-------------------------------------|--------------------------------|---------------------------|--------------------|--------------------------------|---------------------------|
|   | Average<br>Balance                  | Interest<br>Income/<br>Expense | Average<br>Yield/<br>Rate | Average<br>Balance | Interest<br>Income/<br>Expense | Average<br>Yield/<br>Rate |
| <b>ASSETS</b>   |                                     |                                |                           |                    |                                |                           |
| Interest earning deposits in other banks and federal funds sold | \$21,593                            | \$56                           | 1.04 %                    | \$20,952           | \$20                           | 0.38 %                    |
| Securities: <sup>(1)</sup>                                      |                                     |                                |                           |                    |                                |                           |
| Taxable securities  | 319,877                             | 1,309                          | 1.64 %                    | 271,850            | 1,047                          | 1.55 %                    |
| Non-taxable securities <sup>(2)</sup>                           | 93,688                              | 432                            | 1.85 %                    | 90,428             | 420                            | 1.87 %                    |
| Loans <sup>(3) (4)</sup>  | 1,177,403                           | 17,928                         | 6.11 %                    | 1,096,584          | 16,420                         | 6.02 %                    |
| Non-marketable equity securities                                | 2,306                               | 5                              | 0.87 %                    | 2,065              | 2                              | 0.39 %                    |
| Total interest earning assets                                   | 1,614,867                           | 19,730                         | 4.90 %                    | 1,481,879          | 17,909                         | 4.86 %                    |
| Allowance for loan losses                                       | (16,658 )                           |                                |                           | (15,873 )          |                                |                           |
| Non-interest earning assets                                     | 100,457                             |                                |                           | 97,503             |                                |                           |
| Total average assets  | \$1,698,666                         |                                |                           | \$1,563,509        |                                |                           |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                     |                                     |                                |                           |                    |                                |                           |
| Interest bearing deposits:                                      |                                     |                                |                           |                    |                                |                           |
| Demand and savings accounts                                     | \$660,563                           | \$416                          | 0.25 %                    | \$591,976          | \$415                          | 0.28 %                    |
| Money market accounts   | 168,022                             | 95                             | 0.23 %                    | 144,747            | 83                             | 0.23 %                    |
| Certificates of deposit, under \$100,000                        | 89,010                              | 136                            | 0.61 %                    | 96,545             | 76                             | 0.32 %                    |
| Certificates of deposit, \$100,000 and over                     | 62,967                              | 74                             | 0.47 %                    | 75,228             | 123                            | 0.66 %                    |
| Total interest bearing deposits                                 | 980,562                             | 721                            | 0.29 %                    | 908,496            | 697                            | 0.31 %                    |
| Short-term borrowings   | 12,428                              | 28                             | 0.90 %                    | 9,651              | 1                              | 0.04 %                    |
| Total interest bearing liabilities                              | 992,990                             | 749                            | 0.30 %                    | 918,147            | 698                            | 0.31 %                    |
| Non-interest bearing deposits                                   | 454,235                             |                                |                           | 414,040            |                                |                           |
| Total funding   | 1,447,225                           | 749                            | 0.21 %                    | 1,332,187          | 698                            | 0.21 %                    |
| Other non-interest bearing liabilities                          | 12,676                              |                                |                           | 12,617             |                                |                           |
| Shareholders' equity  | 238,765                             |                                |                           | 218,705            |                                |                           |
| Total average liabilities and shareholders' equity              | \$1,698,666                         |                                |                           | \$1,563,509        |                                |                           |
| Net interest income   |                                     | \$18,981                       |                           |                    | \$17,211                       |                           |
| Interest rate spread <sup>(5)</sup>                             |                                     |                                | 4.60 %                    |                    |                                | 4.55 %                    |
| Net interest margin <sup>(6)</sup>                              |                                     |                                | 4.71 %                    |                    |                                | 4.67 %                    |

<sup>(1)</sup> Excludes average unrealized gains (losses) of (\$786,000) and \$1.5 million for the three months ended June 30, 2017 and 2016, respectively, which are included in non-interest earning assets.

<sup>(2)</sup> The average yield does not include the federal tax benefits relating to income earned on municipal securities totaling \$233,000 and \$226,000 for the three months ended June 30, 2017 and 2016, respectively.

<sup>(3)</sup> Loan interest income includes loan fees of \$1.6 million and \$1.4 million for the three months ended June 30, 2017 and 2016, respectively.

<sup>(4)</sup> Average loans do not include average non-accrual loans of \$6.6 million and \$5.3 million for the three months ended June 30, 2017 and 2016, respectively, which are included in non-interest earning assets.

<sup>(5)</sup> Interest rate spread is the difference between the yield on interest-earning assets minus the rate on interest-bearing liabilities.

<sup>(6)</sup> Net interest margin is computed by dividing net interest income by average interest earning assets.



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| (Dollars in thousands, except footnotes)                        | Six Months Ended<br>June 30, 2017 |                                |                           | June 30, 2016      |                                |                           |
|---|-----------------------------------|--------------------------------|---------------------------|--------------------|--------------------------------|---------------------------|
|   | Average<br>Balance                | Interest<br>Income/<br>Expense | Average<br>Yield/<br>Rate | Average<br>Balance | Interest<br>Income/<br>Expense | Average<br>Yield/<br>Rate |
| <b>ASSETS</b>   |                                   |                                |                           |                    |                                |                           |
| Interest earning deposits in other banks and federal funds sold | \$31,168                          | \$135                          | 0.87 %                    | \$18,400           | \$38                           | 0.42 %                    |
| Securities: <sup>(1)</sup>                                      |                                   |                                |                           |                    |                                |                           |
| Taxable securities  | 317,342                           | 2,510                          | 1.59 %                    | 281,738            | 2,186                          | 1.56 %                    |
| Non-taxable securities <sup>(2)</sup>                           | 92,930                            | 854                            | 1.85 %                    | 92,923             | 863                            | 1.87 %                    |
| Loans <sup>(3) (4)</sup>  | 1,156,661                         | 34,781                         | 6.06 %                    | 1,078,687          | 32,272                         | 6.02 %                    |
| Non-marketable equity securities                                | 2,070                             | 8                              | 0.78 %                    | 2,401              | 4                              | 0.34 %                    |
| Total interest earning assets                                   | 1,600,171                         | 38,288                         | 4.83 %                    | 1,474,149          | 35,363                         | 4.82 %                    |
| Allowance for loan losses                                       | (16,713 )                         |                                |                           | (15,733 )          |                                |                           |
| Non-interest earning assets                                     | 99,498                            |                                |                           | 96,811             |                                |                           |
| Total average assets  | \$1,682,956                       |                                |                           | \$1,555,227        |                                |                           |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                     |                                   |                                |                           |                    |                                |                           |
| Interest bearing deposits:                                      |                                   |                                |                           |                    |                                |                           |
| Demand and savings accounts                                     | \$660,026                         | \$854                          | 0.26 %                    | \$586,911          | \$818                          | 0.28 %                    |
| Money market accounts   | 171,221                           | 200                            | 0.24 %                    | 146,018            | 177                            | 0.24 %                    |
| Certificates of deposit, under \$100,000                        | 89,685                            | 272                            | 0.61 %                    | 97,183             | 161                            | 0.33 %                    |
| Certificates of deposit, \$100,000 and over                     | 64,447                            | 160                            | 0.50 %                    | 75,545             | 258                            | 0.69 %                    |
| Total interest bearing deposits                                 | 985,379                           | 1,486                          | 0.30 %                    | 905,657            | 1,414                          | 0.31 %                    |
| Short-term borrowings   | 7,856                             | 29                             | 0.74 %                    | 20,507             | 38                             | 0.37 %                    |
| Total interest bearing liabilities                              | 993,235                           | 1,515                          | 0.31 %                    | 926,164            | 1,452                          | 0.32 %                    |
| Non-interest bearing deposits                                   | 442,861                           |                                |                           | 401,580            |                                |                           |
| Total funding   | 1,436,096                         | 1,515                          | 0.21 %                    | 1,327,744          | 1,452                          | 0.22 %                    |
| Other non-interest bearing liabilities                          | 11,325                            |                                |                           | 11,409             |                                |                           |
| Shareholders' equity  | 235,535                           |                                |                           | 216,074            |                                |                           |
| Total average liabilities and shareholders' equity              | \$1,682,956                       |                                |                           | \$1,555,227        |                                |                           |
| Net interest income   |                                   | \$36,773                       |                           |                    | \$33,911                       |                           |
| Interest rate spread <sup>(5)</sup>                             |                                   |                                | 4.52 %                    |                    |                                | 4.50 %                    |
| Net interest margin <sup>(6)</sup>                              |                                   |                                | 4.63 %                    |                    |                                | 4.63 %                    |

<sup>(1)</sup>Excludes average unrealized gains (losses) of (\$1.2) million and \$1.1 million for the six months ended June 30, 2017 and 2016, respectively, which are included in non-interest earning assets.

<sup>(2)</sup>The average yield does not include the federal tax benefits relating to income earned on municipal securities totaling \$460,000 and \$464,000 for the six months ended June 30, 2017 and 2016, respectively.

<sup>(3)</sup>Loan interest income includes loan fees of \$3.0 million and \$2.8 million for the six months ended June 30, 2017 and 2016, respectively.

<sup>(4)</sup>Average loans do not include average non-accrual loans of \$6.1 million and \$5.8 million for the six months ended June 30, 2017 and 2016, respectively, which are included in non-interest earning assets.

<sup>(5)</sup>Interest rate spread is the difference between the yield on interest-earning assets minus the rate on interest-bearing liabilities.

<sup>(6)</sup>Net interest margin is computed by dividing net interest income by average interest earning assets.





Rate/Volume Analysis. The following table shows the change in interest income and interest expense and the amount of change attributable to variances in volume, rates and the combination of volume and rates based on the relative changes of volume and rates. For purposes of this table, the change in interest due to both volume and rate has been allocated to change due to volume and rate in proportion to the relationship of absolute dollar amounts of change in each.

| (Dollars in thousands)  | Three Months Ended<br>June 30,<br>2017 vs. 2016 |              |                | Six Months Ended June<br>30,<br>2017 vs. 2016 |              |                |
|---|---|--------------|----------------|---|--------------|----------------|
|   | Increase (Decrease)                             |              |                | Increase (Decrease)                           |              |                |
|   | Due to:   |              |                | Due to:                                       |              |                |
|   | Volume  | Rate         | Net            | Volume  | Rate         | Net            |
| <b>Interest income:</b>   |   |              |                |   |              |                |
| Interest earning deposits in other banks and federal funds sold | \$1   | \$35         | \$36           | \$38  | \$59         | \$97           |
| Taxable securities  | 194   | 68           | 262            | 281   | 43           | 324            |
| Non-taxable securities  | 15  | (3 )         | 12             | —   | (9 )         | (9 )           |
| Loans   | 1,227   | 281          | 1,508          | 2,344   | 165          | 2,509          |
| Federal Home Loan Bank stock                                    | —   | 3            | 3              | (1 )  | 5            | 4              |
| <b>Total interest income</b>                                    | <b>1,437</b>                                    | <b>384</b>   | <b>1,821</b>   | <b>2,662</b>                                  | <b>263</b>   | <b>2,925</b>   |
| <b>Interest expense:</b>  |   |              |                |   |              |                |
| Demand and savings accounts                                     | 45  | (44 )        | 1              | 97  | (61 )        | 36             |
| Money market accounts   | 13  | (1 )         | 12             | 30  | (7 )         | 23             |
| Certificates of deposit, under \$100,000                        | (6 )  | 66           | 60             | (13 )   | 124          | 111            |
| Certificates of deposit, \$100,000 and over                     | (18 )   | (31 )        | (49 )          | (34 )   | (64 )        | (98 )          |
| Short-term borrowings   | —   | 27           | 27             | (32 )   | 23           | (9 )           |
| <b>Total interest expense</b>                                   | <b>34</b>                                       | <b>17</b>    | <b>51</b>      | <b>48</b>                                     | <b>15</b>    | <b>63</b>      |
| <b>Net interest income</b>                                      | <b>\$1,403</b>                                  | <b>\$367</b> | <b>\$1,770</b> | <b>\$2,614</b>                                | <b>\$248</b> | <b>\$2,862</b> |

Net interest income increased \$1.8 million for the three months ended June 30, 2017 compared to the same period in 2016. The increase in interest income was primarily driven by increased organic loan volumes, slightly higher loan yields and increases in investment securities. Additionally, interest expense also increased for the three months ended June 30, 2017 compared to the same period in 2016 due principally to increases in deposits offset by slightly lower deposit interest rates.

Net interest income increased \$2.9 million for the six months ended June 30, 2017 compared to the same period in 2016. The increase in interest income was primarily driven by increased organic loan volumes, slightly higher loan yields, and increases in investment securities. Additionally, interest expense also increased for the six months ended June 30, 2017 compared to the same period in 2016 due principally to increases in deposits offset by slightly lower deposit interest rates.



Financial Overview for the Three Months Ended June 30, 2017 and 2016

| (Dollars in thousands)                              | Three Months Ended |               | \$      | %     |   |
|---|--------------------|---------------|---------|-------|---|
|   | June 30, 2017      | June 30, 2016 |         |       |   |
| Interest income                                     | \$19,730           | \$17,909      | \$1,821 | 10.2  | % |
| Interest expense                                    | 749                | 698           | 51      | 7.3   | % |
| Net interest income                                 | 18,981             | 17,211        | 1,770   | 10.3  | % |
| Provision for loan losses                           | 900                | 225           | 675     | 300.0 | % |
| Net interest income after provision for loan losses | 18,081             | 16,986        | 1,095   | 6.4   | % |
| Non-interest income                                 | 4,348              | 4,398         | (50)    | -1.1  | % |
| Non-interest expense                                | 12,351             | 12,400        | (49)    | -0.4  | % |
| Income before income tax expense                    | 10,078             | 8,984         | 1,094   | 12.2  | % |
| Income tax expense                                  | 3,584              | 3,407         | 177     | 5.2   | % |
| Net income  | \$6,494            | \$5,577       | \$917   | 16.4  | % |

Net Income. Our net income grew by \$917,000 or 16.4% to \$6.5 million for the quarter ended June 30, 2017 as compared to \$5.6 million for the same quarter in 2016. This was attributable principally to an increase in net interest income of \$1.8 million, and offset by an increase of \$675,000 in loan loss provision and \$177,000 of higher income tax expenses.

Net Interest Income and Net Interest Margin. The increase in net interest income for the quarter ended June 30, 2017 compared to the same quarter in 2016 was primarily driven by interest earned on a higher average loan volume attributable to organic growth. Interest expense in the quarter ended June 30, 2017 increased from the same period in 2016 due to higher volume in average deposits. Construction and land development loans ("C & D loans") are our highest yielding assets within our earning asset mix and represents 20.9% of gross loans as of June 30, 2017. If C & D loan activity declines as a percentage of earning asset mix in future quarters, the net interest margin could decline from current levels.

The yield on our average interest earning assets was 4.90% for the quarter ended June 30, 2017 compared to 4.86% for the comparable quarter in 2016. The cost of funding our earning assets declined in the quarter ended June 30, 2017 to 0.30% from 0.31% in the comparable quarter in 2016 because of lower rates paid on deposits and accretion of fair value adjustments to certificates of deposit.

Provision for Loan Losses. The provision for loan losses in each period is a charge against earnings in that period. The provision is that amount required to maintain the allowance for loan losses at a level that, in management's judgment, is adequate to absorb loan losses inherent in the loan portfolio.

The provision for loan losses for each of the quarters ended June 30, 2017 and 2016 was \$900,000 and \$225,000, respectively. We have experienced net charge-offs of \$273,000 in the current quarter compared to net recoveries of (\$204,000) in the comparable quarter in 2016. The provision for loan losses in both periods were primarily due to the impact of the charge-offs and relative increases in loan balances.

Non-interest Income. The following table presents, for the periods indicated, the major categories of non-interest income:

|                                     | Three Months Ended |          |           |          |
|-------------------------------------|--------------------|----------|-----------|----------|
|                                     | June 30,           | June 30, |           |          |
| (Dollars in thousands)              | 2017               | 2016     | \$ Change | % Change |
| Mortgage banking                    | 1,960              | 2,277    | (317 )    | -13.9 %  |
| Card processing                     | 1,208              | 1,136    | 72        | 6.3 %    |
| Service charges on deposit accounts | \$578              | \$531    | \$ 47     | 8.9 %    |
| Other operating                     | 602                | 454      | 148       | 32.6 %   |
| Total non-interest income           | \$4,348            | \$4,398  | \$ (50 )  | -1.1 %   |

The decrease in total non-interest income during the quarter ended June 30, 2017 compared to the same quarter in 2016 was primarily influenced by lower mortgage banking income from lower mortgage volumes and offset by higher card processing income and various other operating income which includes a gain of approximately \$134,000 relating to the sale of land held by the Bank.

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Non-interest Expense. The following table presents, for the periods indicated, the major categories of non-interest expense:

| (Dollars in thousands)                | Three Months Ended |               | \$        | %     |   |
|---------------------------------------|--------------------|---------------|-----------|-------|---|
|                                       | June 30, 2017      | June 30, 2016 |           |       |   |
| Salaries and employee benefits        | \$7,762            | \$7,959       | \$ (197 ) | -2.5  | % |
| Occupancy, equipment and depreciation | 1,088              | 1,076         | 12        | 1.1   | % |
| Data processing                       | 661                | 740           | (79 )     | -10.7 | % |
| Card processing                       | 516                | 549           | (33 )     | -6.0  | % |
| Marketing and advertising             | 349                | 290           | 59        | 20.3  | % |
| FDIC premiums                         | 130                | 188           | (58 )     | -30.9 | % |
| Other                                 | 1,845              | 1,598         | 247       | 15.5  | % |
| Total non-interest expense            | \$12,351           | \$12,400      | \$ (49 )  | -0.4  | % |

Non-interest expense for the second quarter of 2017 was relatively flat, only decreasing by \$49,000, as compared to the same period in 2016, primarily due to an increase in various other expenses of \$247,000 and offset by lower salaries and employee benefits, lower data processing costs and lower rates on FDIC premiums. Our personnel costs have increased in 2017 due to annual salary increases, higher variable compensation costs, higher payroll tax and medical benefits to support our balance sheet and income growth, offset by approximately \$500,000 refund on medical benefit premiums received in the second quarter of 2017 contributing to the decrease in salaries and benefits. We expect non-interest expenses to increase in future quarters due to the recent opening of two new branches and future merger and acquisition costs related to the pending acquisitions.

Income Tax Expense. We recorded an income tax expense of \$3.6 million for the three months ended June 30, 2017 compared to \$3.4 million for the same period in 2016. The effective tax rate for the three months of 2017 was 35.6% compared to 37.9% in the corresponding three months of 2016. The tax rate in the second quarter of 2017 is lower than the same quarter in 2016 due primarily to adjustments in the expected recoverability of certain tax credits.

Financial Overview for the Six Months Ended June 30, 2017 and 2016

| (Dollars in thousands)                              | Six Months Ended |               | \$       | %     |   |
|---|------------------|---------------|----------|-------|---|
|   | June 30, 2017    | June 30, 2016 |          |       |   |
| Interest income                                     | \$38,288         | \$35,363      | \$ 2,925 | 8.3   | % |
| Interest expense                                    | 1,515            | 1,452         | 63       | 4.3   | % |
| Net interest income                                 | 36,773           | 33,911        | 2,862    | 8.4   | % |
| Provision for loan losses                           | 1,100            | 425           | 675      | 158.8 | % |
| Net interest income after provision for loan losses | 35,673           | 33,486        | 2,187    | 6.5   | % |
| Non-interest income                                 | 8,473            | 8,161         | 312      | 3.8   | % |
| Non-interest expense                                | 24,807           | 24,535        | 272      | 1.1   | % |
| Income before income tax expense                    | 19,339           | 17,112        | 2,227    | 13.0  | % |
| Income tax expense                                  | 6,324            | 6,292         | 32       | 0.5   | % |

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Net income \$13,015 \$10,820 \$ 2,195 20.3 %

Net Income. Our net income grew by \$2.2 million or 20.3% to \$13.0 million for the six months ended June 30, 2017 as compared to \$10.8 million for the same period in 2016. This was attributable principally to an increase in net interest income of \$2.9 million, and offset primarily by an increase of \$675,000 in loan loss provision.

Net Interest Income and Net Interest Margin. The increase in net interest income for the six months ended June 30, 2017 compared to the same period in 2016 was primarily driven by interest earned on a higher average loan volume attributable to organic growth. Interest expense in the six months ended June 30, 2017 increased from the same period in 2016 due to higher volume in average deposits. As stated previously, C & D loans are our highest yielding assets within our earning asset mix and represents 20.9% of gross loans as of June 30, 2017. If C & D loan activity declines as a percentage of earning asset mix in future quarters, the net interest margin could decline from current levels.

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The yield on our average interest earning assets was 4.83% for the six months ended June 30, 2017 compared to 4.82% for the same period in 2016. The cost of funding our earning assets declined in the six months ended June 30, 2017 to 0.31% from 0.32% in the comparable period in 2016 because of lower rates paid on deposits and accretion of fair value adjustments to certificates of deposit.

Provision for Loan Losses. The provision for loan losses in each period is a charge against earnings in that period. The provision is that amount required to maintain the allowance for loan losses at a level that, in management's judgment, is adequate to absorb loan losses inherent in the loan portfolio.

The provision for loan losses for each of the six months ended June 30, 2017 and 2016 was \$1.1 million and \$425,000, respectively. We have experienced net charge-offs of \$544,000 in the six months ended June 30, 2017, compared to net recoveries of (\$170,000) in the comparable period in 2016. The provision for loan losses in both periods were primarily due to the impact of the charge-offs and relative increases in loan balances.

Non-interest Income. The following table presents, for the periods indicated, the major categories of non-interest income:

|                                     | Six Months Ended |               |        |        |
|-------------------------------------|------------------|---------------|--------|--------|
|                                     | June 30, 2017    | June 30, 2016 |        |        |
| (Dollars in thousands)              |                  |               | \$     | %      |
|                                     | 2017             | 2016          | Change | Change |
| Mortgage banking                    | 3,939            | 4,025         | (86 )  | -2.1 % |
| Card processing                     | 2,332            | 2,167         | 165    | 7.6 %  |
| Service charges on deposit accounts | \$ 1,114         | \$ 1,044      | \$ 70  | 6.7 %  |
| Other operating                     | 1,088            | 925           | 163    | 17.6 % |
| Total non-interest income           | \$ 8,473         | \$ 8,161      | \$ 312 | 3.8 %  |

The increase in total non-interest income during the six months ended June 30, 2017 compared to the same period in 2016 was primarily influenced by higher card processing income and various other operating income which includes approximately \$134,000 gain relating to the sale of land held by the Bank, and offset by lower mortgage banking income from lower mortgage volumes.

Non-interest Expense. The following table presents, for the periods indicated, the major categories of non-interest expense:

|                                       | Six Months Ended |               |           |        |
|---------------------------------------|------------------|---------------|-----------|--------|
|                                       | June 30, 2017    | June 30, 2016 |           |        |
| (Dollars in thousands)                |                  |               | \$        | %      |
|                                       | 2017             | 2016          | Change    | Change |
| Salaries and employee benefits        | \$ 15,729        | \$ 15,843     | \$ (114 ) | -0.7 % |
| Occupancy, equipment and depreciation | 2,205            | 2,064         | 141       | 6.8 %  |
| Data processing                       | 1,336            | 1,447         | (111 )    | -7.7 % |
| Card processing                       | 1,045            | 1,139         | (94 )     | -8.3 % |
| Marketing and advertising             | 611              | 459           | 152       | 33.1 % |



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|                            |          |          |        |         |
|----------------------------|----------|----------|--------|---------|
| FDIC premiums              | 256      | 383      | (127 ) | -33.2 % |
| Other                      | 3,625    | 3,200    | 425    | 13.3 %  |
| Total non-interest expense | \$24,807 | \$24,535 | \$ 272 | 1.1 %   |

Non-interest expense for the first six months of 2017 increased by \$272,000, compared to the same period in 2016, primarily due to an increase in various other expenses of \$425,000 and offset by lower salaries and employee benefits, lower data processing costs and lower rates on FDIC premiums. Our personnel costs have increased in 2017 due to annual salary increases, higher variable compensation costs, higher payroll tax and medical benefits to support our balance sheet and income growth, offset by a \$500,000 refund on medical benefit premiums received in the second quarter of 2017 contributing to the decrease in salaries and benefits.

**Income Tax Expense.** We recorded an income tax expense of \$6.3 million for the six months ended June 30, 2017 compared to \$6.3 million for the same period in 2016. The effective tax rate for the first six months of 2017 was 32.7% compared to 36.8% in the corresponding six months of 2016. The tax rate in 2017 is lower than 2016 due primarily to tax-deductible stock compensation expense and the reversal of a liability related to an unrecognized tax benefit, totaling approximately \$600,000 in taxable benefits.

Financial Condition

Our total assets as of June 30, 2017 were \$1.72 billion, a 3.1% increase compared to December 31, 2016. Our total loans held for investment as of June 30, 2017 were \$1.20 billion, an increase of 7.3% from December 31, 2016. Total deposits as of June 30, 2017 were \$1.46 billion, an increase of 2.5% compared to December 31, 2016.

Loans

The following table sets forth information regarding the composition of the loan portfolio at the end of each of the periods presented.

| (Dollars in thousands)             | June 30,<br>2017 | December<br>31,<br>2016 |
|------------------------------------|------------------|-------------------------|
| Loans held for sale                | \$7,655          | \$20,826                |
| Loans held for investment:         |                  |                         |
| Commercial real estate loans:      |                  |                         |
| Real estate term                   | 643,756          | 582,029                 |
| Construction and land development  | 251,741          | 240,120                 |
| Total commercial real estate loans | 895,497          | 822,149                 |
| Commercial and industrial loans    | 221,901          | 213,260                 |
| Consumer loans:                    |                  |                         |
| Residential and home equity        | 73,791           | 72,959                  |
| Consumer and other                 | 14,936           | 15,678                  |
| Total consumer loans               | 88,727           | 88,637                  |
| Total gross loans                  | 1,206,125        | 1,124,046               |
| Net deferred loan fees             | (4,734 )         | (4,169 )                |
| Allowance for loan losses          | (17,271 )        | (16,715 )               |
| Loans held for investment, net     | \$1,184,120      | \$1,103,162             |

| (Percentage of total loans held for investment) | June<br>30,<br>2017 | December<br>31,<br>2016 |
|---|---------------------|-------------------------|
| Loans held for investment:                      |                     |                         |
| Commercial real estate loans:                   |                     |                         |
| Real estate term                                | 53.4 %              | 51.7 %                  |
| Construction and land development               | 20.9 %              | 21.4 %                  |
| Total commercial real estate loans              | 74.3 %              | 73.1 %                  |
| Commercial and industrial loans                 | 18.4 %              | 19.0 %                  |
| Consumer loans:                                 |                     |                         |
| Residential and home equity                     | 6.1 %               | 6.5 %                   |
| Consumer and other                              | 1.2 %               | 1.4 %                   |
| Total consumer loans                            | 7.3 %               | 7.9 %                   |
| Total loans held for investment                 | 100.0 %             | 100.0 %                 |

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We originate certain residential mortgage loans for sale to investors that are carried at cost. Due to the short period held, generally less than 90 days, we consider these loans held for sale to be carried at fair value.

The following table shows the amounts of outstanding loans, which, based on remaining scheduled repayments of principal, were due in one year or less, more than one year through five years, and more than five years. Lines of credit or other loans having no stated maturity and no stated schedule of repayments are reported as due in one year or less. In the table below, loans are classified as real estate related if they are collateralized by real estate. The tables also present, for loans with maturities over one year, an analysis with respect to fixed interest rate loans and adjustable interest rate loans.

Contractual maturities as of June 30, 2017 are as follows:

|                                       | Maturity         |                        |                  | Total       | Rate Structure for Loans Maturing Over One Year |                 |
|---------------------------------------|------------------|------------------------|------------------|-------------|---|-----------------|
|                                       | One Year or Less | One through Five Years | After Five Years |             | Fixed Rate                                      | Adjustable Rate |
| (Dollars in thousands)                |                  |                        |                  |             |   |                 |
| Loans held for investment:            |                  |                        |                  |             |   |                 |
| Commercial real estate loans:         |                  |                        |                  |             |   |                 |
| Real estate term                      | \$77,976         | \$219,635              | \$346,145        | \$643,756   | \$113,508                                       | \$452,272       |
| Construction and land development     | 204,349          | 44,080                 | 3,312            | 251,741     | 20,540  | 26,852          |
| Total commercial real estate loans    | 282,325          | 263,715                | 349,457          | 895,497     | 134,048   | 479,124         |
| Commercial and industrial loans       | 86,216           | 104,763                | 30,922           | 221,901     | 88,294  | 47,391          |
| Consumer loans:                       |                  |                        |                  |             |   |                 |
| Residential and home equity           | 12,517           | 16,778                 | 44,496           | 73,791      | 10,278  | 50,996          |
| Consumer and other                    | 6,414            | 6,886                  | 1,636            | 14,936      | 7,979   | 543             |
| Total consumer loans                  | 18,931           | 23,664                 | 46,132           | 88,727      | 18,257  | 51,539          |
| Total gross loans held for investment | \$387,472        | (1)\$392,142           | \$426,511        | \$1,206,125 | \$240,599                                       | \$578,054       |

(1)The sum of adjustable rate loans maturing after one year and total loans maturing within one year is \$966 million or 80.1% of total loans at June 30, 2017.

Concentrations. As of June 30, 2017, in management's judgment, a concentration of loans existed in real estate related loans. At that date, real estate related loans comprised 80.4% of total loans held for investment, of which commercial real estate represents 53.4%, 20.9% are construction and land development loans, and 6.1% are residential and home equity loans. We require collateral on real estate lending arrangements and typically maintain loan-to-value ratios of up to 80%, except for some residential construction loans of up to 95% loan-to-value provided the loan includes pre-approved long-term financing. Our concentration in commercial and industrial loans has slightly decreased to 18.4% as of June 30, 2017 from 19.0% as of December 31, 2016. We have focused on diversifying our loan portfolio mix since 2011 resulting in an increase in our concentration of commercial and industrial loans from 15.5% as of December 31, 2011, to 18.4% as of June 30, 2017.

Non-Performing Assets. Loans are placed on non-accrual status when they become 90 days or more past due or at such earlier time as management determines timely recognition of interest to be in doubt. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions, collection efforts, and the borrower's financial condition, that the borrower will be unable to make payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received, or payment is considered certain. Loans may be returned to accrual status when all delinquent interest and principal amounts contractually due are brought current and future payments are reasonably assured.

The following table summarizes the loans for which the accrual of interest has been discontinued and loans more than 90 days past due and still accruing interest, including those non-accrual loans that are troubled-debt restructured loans, and OREO:

|   | June<br>30,<br>2017 | December<br>31,<br>2016 |  |
|---|---------------------|-------------------------|--|
| (Dollars in thousands)                                  |                     |                         |  |
| Non-accrual loans, not troubled-debt restructured       |                     |                         |  |
| Real estate term  | \$4,089             | \$ 2,386                |  |
| Construction and land development                       | 826                 | 378                     |  |
| Commercial and industrial                               | 1,513               | 1,211                   |  |
| Residential and home equity                             | 116                 | 142                     |  |
| Consumer and other                                      | —                   | 14                      |  |
| Total non-accrual, not troubled-debt restructured loans | 6,544               | 4,131                   |  |
| Troubled-debt restructured loans non-accrual            |                     |                         |  |
| Real estate term  | 663                 | 808                     |  |
| Construction and land development                       | 383                 | 396                     |  |
| Commercial and industrial                               | —                   | —                       |  |
| Residential and home equity                             | —                   | —                       |  |
| Consumer and other                                      | —                   | —                       |  |
| Total troubled-debt restructured, non-accrual loans     | 1,046               | 1,204                   |  |
| Total non-accrual loans <sup>(1)</sup>                  | 7,590               | 5,335                   |  |
| Accruing loans past due 90 days or more                 | 21                  | 22                      |  |
| Total non-performing loans (NPL)                        | 7,611               | 5,357                   |  |
| OREO  | 468                 | 245                     |  |
| Total non-performing assets (NPA) <sup>(2)</sup>        | \$8,079             | \$ 5,602                |  |
| Accruing troubled debt restructured loans               | \$4,162             | \$ 5,572                |  |
| Non-accrual troubled debt restructured loans            | 1,046               | 1,204                   |  |
| Total troubled debt restructured loans                  | \$5,208             | \$ 6,776                |  |
| Selected ratios:  |                     |                         |  |
| NPL to total loans                                      | 0.64 %              | 0.49 %                  |  |
| NPA to total assets                                     | 0.47 %              | 0.34 %                  |  |

<sup>(1)</sup> We estimate that approximately \$189,000 and \$298,000 of interest income would have been recognized on loans accounted for on a non-accrual basis for the six months ended June 30, 2017 and the year ended December 31, 2016, respectively, had such loans performed pursuant to contractual terms.

<sup>(2)</sup> Non-performing assets as of December 31, 2016 have not been reduced by U.S. government guarantees of \$16,000. There were no U.S. Government guarantees on non-performing assets as of June 30, 2017.

Impaired Loans. Impaired loans are loans for which it is probable that we will be unable to collect all principal and interest payments due according to the contractual terms of the loan agreement. We measure impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the fair value of the collateral, if the loan is collateral-dependent.

In determining whether or not a loan is impaired, we consider payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. We determine the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all the circumstances surrounding the loan and

borrower, including the length of delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Loans for which an insignificant shortfall in amount of payments is anticipated, but where we expect to collect all amounts due, are not considered impaired.

**Troubled-debt Restructured Loans.** A restructured loan is considered a troubled debt restructured loan, or TDR, if we, for economic or legal reasons related to the debtor's financial difficulties, grant a concession in terms or a below-market interest rate to the debtor that we would not otherwise consider. We had TDR loans of \$5.2 million and \$6.8 million as of June 30, 2017 and December 31, 2016, respectively. Our TDR loans are considered impaired loans of which \$1.05 million and \$1.20 million as of June 30, 2017 and December 31, 2016, respectively, are designated as non-accrual.

Each restructured debt is separately negotiated with the borrower and includes terms and conditions that reflect the borrower's prospective ability to service the debt as modified.

OREO Properties. OREO represents real property taken either through foreclosure or through a deed in lieu thereof from the borrower. All OREO properties are recorded by us at amounts equal to or less than the fair market value of the properties based on current independent appraisals reduced by estimated selling costs. The following table provides a summary of the changes in the OREO balance:

|                              | Six Months |       |
|------------------------------|------------|-------|
|                              | Ended      |       |
|                              | June       | June  |
| (Dollars in thousands)       | 30,        | 30,   |
|                              | 2017       | 2016  |
| Balance, beginning of period | \$245      | \$568 |
| Additions                    | 468        | 237   |
| Write-downs                  | —          | (53 ) |
| Sales                        | (245)      | (108) |
| Balance, end of period       | \$468      | \$644 |

#### Allowance for Loan Losses

We maintain an adequate allowance for loan losses, or ALLL, based on a comprehensive methodology that assesses the losses inherent in the loan portfolio. Our ALLL is based on a continuing review of loans which includes consideration of actual loss experience, changes in the size and character of the portfolio, identification of individual problem situations which may affect the borrower's ability to repay, evaluations of the prevailing and anticipated economic conditions, and other qualitative factors. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

Our ALLL is increased by charges to income and decreased by charge-offs (net of recoveries). While we use available information to recognize losses on loans, changes in economic conditions may necessitate revision of the estimate in future years.

The ALLL consists of specific and general components. The specific component relates to loans determined to be impaired that are individually evaluated for impairment. For impaired loans individually evaluated, an allowance is established when the discounted cash flows, or the fair value of the collateral if the loans are collateral-dependent, of the impaired loan are lower than the carrying value of the loan. The general component covers all loans not individually evaluated for impairment and is based on historical loss experience adjusted for qualitative factors. Various qualitative factors are considered including changes to underwriting policies, loan concentrations, volume and mix of loans, size and complexity of individual credits, locations of credits and new market areas, changes in local and national economic conditions, and trends in past due, non-accrual and classified loan balances.





The following table sets forth the activity in our allowance for loan losses for the periods indicated:

| (Dollars in thousands)                                 | Three Months Ended |                  | Six Months Ended |                  |
|--|--------------------|------------------|------------------|------------------|
|  | June 30,<br>2017   | June 30,<br>2016 | June 30,<br>2017 | June 30,<br>2016 |
| <b>Allowance for loan losses:</b>                      |                    |                  |                  |                  |
| Beginning balance                                      | \$16,644           | \$15,723         | \$16,715         | \$15,557         |
| <b>Loans charged off:</b>                              |                    |                  |                  |                  |
| Real estate term                                       | (350 )             | —                | (350 )           | —                |
| Construction and land development                      | —                  | —                | —                | —                |
| Commercial and industrial                              | (114 )             | —                | (272 )           | (72 )            |
| Residential and home equity                            | —                  | —                | (338 )           | —                |
| Consumer and other                                     | (48 )              | (56 )            | (113 )           | (120 )           |
| <b>Total</b>   | <b>(512 )</b>      | <b>(56 )</b>     | <b>(1,073 )</b>  | <b>(192 )</b>    |
| <b>Recoveries:</b>                                     |                    |                  |                  |                  |
| Real estate term                                       | 177                | 5                | 181              | 9                |
| Construction and land development                      | —                  | 30               | 79               | 46               |
| Commercial and industrial                              | 39                 | 71               | 77               | 108              |
| Residential and home equity                            | 2                  | 77               | 140              | 81               |
| Consumer and other                                     | 21                 | 77               | 52               | 118              |
| <b>Total</b>   | <b>239</b>         | <b>260</b>       | <b>529</b>       | <b>362</b>       |
| Net loan (charge-offs) recoveries                      | (273 )             | 204              | (544 )           | 170              |
| Provision for loan losses                              | 900                | 225              | 1,100            | 425              |
| Ending balance   | \$17,271           | \$16,152         | \$17,271         | \$16,152         |
| Loans held for investment                              | \$1,201,391        | \$1,095,828      | \$1,201,391      | \$1,095,828      |
| Average loans held for investment                      | 1,168,996          | 1,082,491        | 1,147,263        | 1,065,172        |
| Non-performing loans                                   | 7,611              | 5,383            | 7,611            | 5,383            |
| <b>Selected ratios:</b>                                |                    |                  |                  |                  |
| Net loan charge-offs (recoveries) to average loans     | 0.09               | % -0.07          | % 0.09           | % -0.03          |
| Provision for loan losses to average loans             | 0.31               | % 0.08           | % 0.19           | % 0.08           |
| Allowance for loan losses to loans held for investment | 1.43               | % 1.47           | % 1.43           | % 1.47           |

The decrease in ALLL as a percentage of total loans from 2016 to 2017 is attributable to overall improvement in the credit quality of the underlying loan portfolio, changes to our historical loss rates, and adjustments to qualitative ALLL factors due to changes in current conditions.

Our construction and land development portfolio reflects some borrower concentration risk, and also carries the enhanced risks encountered with construction loans generally. We also finance contractors on a speculative basis. Construction and land development loans are generally more risky than permanent mortgage loans because they are dependent upon the borrower's ability to generate cash to service the loan, and the value of the collateral depends on project completion when market conditions may have changed. Our commercial real estate loans are a mixture of new and seasoned properties, retail, office, warehouse, and some industrial properties. Loans on properties are usually underwritten at a loan to value ratio of up to 75% with a minimum debt coverage ratio of 1.25 times. Our loan portfolio does not include any significant concentrations in oil and gas related businesses.

We allocate our allowance for loan losses by assigning general percentages to our major loan categories (construction and land development, commercial real estate term, residential real estate, C&I and consumer), assigning specific percentages to each category of loans graded in accordance with the guidelines established by our regulatory agencies,

and making specific allocations to impaired loans when factors are present requiring a greater reserve than would be required using the assigned risk rating allocation, which is typically based on a review of appraisals or other collateral analysis.

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The following table indicates management's allocation of the ALLL and the percent of loans in each category to total loans as of each of the following dates:

| (Dollars in thousands)             | June 30,<br>2017 | December<br>31,<br>2016 |
|------------------------------------|------------------|-------------------------|
| Commercial real estate loans:      |                  |                         |
| Real estate term                   | \$7,157          | \$ 6,770                |
| Construction and land development  | 5,077            | 5,449                   |
| Total commercial real estate loans | 12,234           | 12,219                  |
| Commercial and industrial loans    | 4,489            | 3,718                   |
| Consumer loans:                    |                  |                         |
| Residential and home equity        | 503              | 617                     |
| Consumer and other                 | 45               | 161                     |
| Total consumer loans               | 548              | 778                     |
| Total                              | \$17,271         | \$ 16,715               |

| (Percentage of total loans held for investment) | June<br>30,<br>2017 | December<br>31,<br>2016 |
|---|---------------------|-------------------------|
| Commercial real estate loans:                   |                     |                         |
| Real estate term                                | 53.4 %              | 51.7 %                  |
| Construction and land development               | 20.9 %              | 21.4 %                  |
| Total commercial real estate loans              | 74.3 %              | 73.1 %                  |
| Commercial and industrial loans                 | 18.4 %              | 19.0 %                  |
| Consumer loans:                                 |                     |                         |
| Residential and home equity                     | 6.1 %               | 6.5 %                   |
| Consumer and other                              | 1.2 %               | 1.4 %                   |
| Total consumer loans                            | 7.3 %               | 7.9 %                   |
| Total   | 100.0%              | 100.0 %                 |

### Investments

The carrying value of our investment securities totaled \$402.6 million as of June 30, 2017 and \$409.1 million as of December 31, 2016. Our portfolio of investment securities is comprised of both available-for-sale securities and securities that we intend to hold to maturity. As of June 30, 2017, we held no investment securities from any issuer which totaled over 10% of our shareholders' equity.

The carrying value of our portfolio of investment securities was as follows:

June 30,

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| (Dollars in thousands)                               | 2017      | December<br>31,<br>2016 |
|--|-----------|-------------------------|
| <b>Available-for-sale securities: (Fair Value)</b>   |           |                         |
| U.S. Government agencies                             | \$116,774 | \$118,603               |
| Municipal securities                                 | 18,475    | 25,519                  |
| Mortgage-backed securities                           | 180,118   | 181,821                 |
| Corporate securities                                 | 9,805     | 9,666                   |
| Total  | 325,172   | 335,609                 |
| <b>Held-to-maturity securities: (Amortized Cost)</b> |           |                         |
| Municipal securities                                 | 77,394    | 73,512                  |
| Total investment securities                          | \$402,566 | \$409,121               |

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The following table shows the amortized cost for maturities of investment securities and the weighted average yields of such securities, including the benefit of tax-exempt securities:

Investment securities maturities as of June 30, 2017:

| (Dollars in thousands)             | Within One Year |               | After One but within Five Years |               | After Five but within Ten Years |               | After Ten Years  |               | Total            |               |
|------------------------------------|-----------------|---------------|---------------------------------|---------------|---------------------------------|---------------|------------------|---------------|------------------|---------------|
|                                    | Amount          | Yield         | Amount                          | Yield         | Amount                          | Yield         | Amount           | Yield         | Amount           | Yield         |
| Available-for-sale securities:     |                 |               |                                 |               |                                 |               |                  |               |                  |               |
| U.S. Government agencies           | \$20,271        | 1.03 %        | \$87,082                        | 1.18 %        | \$9,849                         | 2.37 %        | \$—              | 0.00 %        | \$117,202        | 1.25 %        |
| Municipal securities               | 5,975           | 2.63 %        | 7,005                           | 3.17 %        | 4,534                           | 2.16 %        | 603              | 2.35 %        | 18,117           | 2.71 %        |
| Mortgage-backed securities         | 6               | 4.98 %        | 5,491                           | 1.23 %        | 70,779                          | 1.63 %        | 104,775          | 2.05 %        | 181,051          | 1.86 %        |
| Other securities                   | —               | 0.00 %        | 3,000                           | 2.16 %        | 4,000                           | 2.21 %        | 3,000            | 4.00 %        | 10,000           | 2.73 %        |
| <b>Total</b>                       | <b>26,252</b>   | <b>1.40 %</b> | <b>102,578</b>                  | <b>1.35 %</b> | <b>89,162</b>                   | <b>1.76 %</b> | <b>108,378</b>   | <b>2.11 %</b> | <b>326,370</b>   | <b>1.72 %</b> |
| Held-to-maturity securities:       |                 |               |                                 |               |                                 |               |                  |               |                  |               |
| Municipal securities               | 7,774           | 1.23 %        | 45,458                          | 1.60 %        | 17,132                          | 1.96 %        | 7,030            | 2.29 %        | 77,394           | 1.71 %        |
| <b>Total investment securities</b> | <b>\$34,026</b> | <b>1.36 %</b> | <b>\$148,036</b>                | <b>1.42 %</b> | <b>\$106,294</b>                | <b>1.80 %</b> | <b>\$115,408</b> | <b>2.12 %</b> | <b>\$403,764</b> | <b>1.72 %</b> |

Actual maturities may differ from contractual maturities because issuers may have the right to call obligations with or without penalties.

We evaluate securities for other-than-temporary impairment at least on an annual basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) our intent and ability to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

#### Deposits

Total deposits were \$1.46 billion as of June 30, 2017 and \$1.43 billion as of December 31, 2016. The increase in total deposits is attributed primarily to our growth in existing markets and entering into new markets. Non-interest bearing demand deposits were \$466.0 million, or 31.9% of total deposits as of June 30, 2017 compared to 31.1% as of December 31, 2016. Interest bearing deposits are comprised of interest bearing DDA accounts, money market accounts, regular savings accounts, certificates of deposit of under \$100,000, and certificates of deposit of \$100,000 or more.

The following table shows the average amount and average rate paid on the categories of deposits for each of the periods presented:

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| (Dollars in thousands)                     | Year to Date       |               | Year Ended         |               |
|--|--------------------|---------------|--------------------|---------------|
|  | June 30, 2017      |               | December 31, 2016  |               |
|  | Average            | Average       | Average            | Average       |
|  | Balance            | Rate          | Balance            | Rate          |
| Non-interest bearing deposits              | \$442,861          | 0.00 %        | \$426,487          | 0.00 %        |
| <b>Interest bearing deposits:</b>          |                    |               |                    |               |
| Interest bearing demand and savings        | 660,026            | 0.26 %        | 607,714            | 0.28 %        |
| Money market                               | 171,221            | 0.24 %        | 150,028            | 0.24 %        |
| Certificates of deposit under \$100,000    | 89,685             | 0.61 %        | 94,689             | 0.32 %        |
| Certificates of deposit \$100,000 and over | 64,447             | 0.50 %        | 73,860             | 0.66 %        |
| Total interest bearing deposits            | 985,379            | 0.30 %        | 926,291            | 0.31 %        |
| <b>Total</b>                               | <b>\$1,428,240</b> | <b>0.21 %</b> | <b>\$1,352,778</b> | <b>0.21 %</b> |

Additionally, the following table shows the maturities of CDs of \$100,000 or more:

| (Dollars in thousands)                       | June 30,<br>2017 |
|--|------------------|
| Due in three months or less                  | \$9,487          |
| Due in over three months through six months  | 12,449           |
| Due in over six months through twelve months | 14,868           |
| Due in over twelve months                    | 33,017           |
| Total  | \$69,821         |

Deposits are gathered from individuals, partnerships and corporations in our market areas. The interest rates paid are competitively priced for each particular deposit product and structured to meet our funding requirements. We will continue to manage interest expense through deposit pricing. Although our cost of funds have declined slightly, short-term interest rates have increased since the fourth quarter of 2016, and we would expect that cost of funds on deposits will increase in future quarters.

#### Shareholders' Equity

As of June 30, 2017, our shareholders' equity totaled \$239.9 million, an increase of \$11.4 million or 5.0% since December 31, 2016. The increase in shareholders' equity for the six-month period ended June 30, 2017 was primarily due to an increase of \$1.0 million in additional paid in capital from exercises of stock options and net income of \$13.0 million for the period less dividends paid of \$2.9 million.

Dividends of \$0.16 per share were declared during the six months ended June 30, 2017 representing 22.0% of the net income for the same period. We increased our quarterly dividend to \$0.09 per share in July 2017 payable in August 2017. Future cash dividends will depend on a variety of factors, including net income, capital, asset quality, general economic conditions, and regulatory considerations.

#### Capital Resources

We are subject to risk-based capital adequacy guidelines related to the adoption of U.S. Basel III Capital Rules. Specifically, the rules impose, among other requirements, new minimum capital requirements including a Tier 1 leverage capital ratio of 4.0%, a common equity Tier 1 risk-based capital ratio of 4.5%, a Tier 1 risk-based capital ratio of 6% and a total risk-based capital ratio of 8%.

The following table sets forth our capital ratios.

| Basel III<br>Regulatory<br>Requirements -<br>Well<br>Capitalized |  |                                      |                                  |
|--|--|--------------------------------------|----------------------------------|
| (Greater than<br>or<br>Equal to<br>Percentage)                   | PUB<br>Actual as<br>of<br>June 30,<br>2017 | Actual as of<br>December 31,<br>2016 | Actual as of<br>June 30,<br>2016 |
|  |  |                                      |                                  |

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|                               |       |   |         |       |   |       |   |
|-------------------------------|-------|---|---------|-------|---|-------|---|
| Common equity tier 1 capital  | 6.50  | % | 18.55 % | 18.93 | % | 18.51 | % |
| Tier 1 risk-based capital     | 8.00  | % | 18.55 % | 18.93 | % | 18.51 | % |
| Total risk-based capital      | 10.00 | % | 19.82 % | 20.19 | % | 19.77 | % |
| Tier 1 leverage capital ratio | 5.00  | % | 14.15 % | 13.71 | % | 14.00 | % |

PUB and the Bank were well-capitalized as of June 30, 2017, December 31, 2016 and June 30, 2016 for federal regulatory purposes.



## Off-Balance Sheet Arrangements

The following table sets forth our off-balance sheet lending commitments as of June 30, 2017:

|  | Total<br>Amounts<br>Committed | Payments Due by Period |                          |                              |                        |
|--|-------------------------------|------------------------|--------------------------|------------------------------|------------------------|
|  |                               | Less than<br>One Year  | One to<br>Three<br>Years | Three<br>to<br>Five<br>Years | After<br>Five<br>Years |
| Other Commitments (Dollars in thousands) |                               |                        |                          |                              |                        |
| Commitments to extend credit             | \$ 516,291                    | \$346,743              | \$106,385                | \$5,841                      | \$57,322               |
| Standby letters of credit                | 29,233                        | 29,233                 | —                        | —                            | —                      |
| Credit cards                             | 25,337                        | 25,337                 | —                        | —                            | —                      |
| <b>Total</b>                             | <b>\$ 570,861</b>             | <b>\$401,313</b>       | <b>\$106,385</b>         | <b>\$5,841</b>               | <b>\$57,322</b>        |

## Contractual Obligations

The following table sets forth our significant contractual obligations as of June 30, 2017:

| Contractual Obligations (Dollars in thousands) | Total              | Payments Due by Period |                          |                           |                        |
|--|--------------------|------------------------|--------------------------|---------------------------|------------------------|
|  |                    | Less than<br>One Year  | One to<br>Three<br>Years | Three to<br>Five<br>Years | After<br>Five<br>Years |
| Time certificates of deposit                   | \$ 149,540         | \$85,368               | \$42,010                 | \$14,414                  | \$7,748                |
| Deposits without stated maturity               | 1,311,512          | 1,311,512              | —                        | —                         | —                      |
| Short-term borrowings                          | 3,302              | 3,302                  | —                        | —                         | —                      |
| <b>Total</b>                                   | <b>\$1,464,354</b> | <b>\$1,400,182</b>     | <b>\$42,010</b>          | <b>\$14,414</b>           | <b>\$7,748</b>         |

## Liquidity

The ability to have readily available funds sufficient to repay fully maturing liabilities is of primary importance to depositors, creditors and regulators. Our liquidity, represented by cash borrowing lines, federal funds and available-for-sale securities, is a result of our operating, investing and financing activities and related cash flows. In order to ensure funds are available at all times, we devote resources to projecting on a monthly basis the amount of funds that will be required and we maintain relationships with a diversified customer base so funds are accessible. Liquidity requirements can also be met through short-term borrowings or the disposition of short-term assets. We have borrowing lines at a correspondent bank totaling \$25.0 million. We also have a current borrowing line with the FHLB, totaling \$326.9 million as of June 30, 2017, which are secured by various real estate loans pledged as collateral totaling \$493.1 million. Additionally, we have a borrowing line with the Federal Reserve Bank of \$21.1 million which is secured by \$21.7 million of investment securities.

We believe our liquid assets are adequate to meet our cash flow needs for loan funding and deposit cash withdrawal for the next 60 to 90 days. As of June 30, 2017, we had approximately \$355.7 million in net liquid assets comprised of \$57.4 million in cash and cash equivalents, including interest bearing deposits of \$26.0 million and federal funds sold of \$3.1 million, \$325.2 million in available-for-sale securities and \$7.7 million in loans held for sale, less \$34.6 million of available-for-sale securities pledged as collateral for short-term borrowings. We monitor liquidity measured by a liquidity ratio defined as cash and cash equivalents plus unpledged investment securities divided by total liabilities. Our liquidity ratio was 28.77% as of June 30, 2017 compared to 30.58% as of December 31, 2016. Our

future liquidity ratio will likely decline as a result of the pending acquisitions of Town & Country Bank and the seven Utah branches of Banner Bank.

On a long-term basis, our liquidity will be met by changing the relative distribution of our asset portfolios by reducing our investment or loan volumes, or selling or encumbering assets. Further, we will increase liquidity by soliciting higher levels of deposit accounts through promotional activities and/or borrowing from our correspondent banks as well as the FHLB. At the current time, our long-term liquidity needs primarily relate to funds required to support loan originations and commitments, deposit withdrawals and pending acquisitions. All of these needs can currently be met by cash flows from investment payments and maturities, and investment sales if the need arises.

Our liquidity is comprised of three primary classifications: cash flows from or used in operating activities; cash flows from or used in investing activities; and cash flows from or used in financing activities.

Net cash provided by or used in operating activities has consisted primarily of net income adjusted for certain non-cash income and expense items such as the loan loss provision, investment and other amortization and depreciation.

Our primary investing activities are the origination of real estate, commercial and consumer loans and purchases and sales of investment securities. As of June 30, 2017, we had outstanding loan commitments of \$516.3 million, credit card commitments of \$25.3 million and outstanding letters of credit of \$29.2 million. We anticipate that we will have sufficient funds available to meet current loan commitments.

Net cash provided from financing activities for the six months ended June 30, 2017 was \$34.0 million, principally from increases in deposit balances offset by dividends paid to shareholders during the period.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company's assessment of market risk as of June 30, 2017 indicates there have been no material changes in the quantitative and qualitative disclosures from those in our Annual Report on Form 10-K for the year ended December 31, 2016 filed with the SEC.

### Item 4. Controls and Procedures

#### Evaluation of Disclosure Controls and Procedures

The Company's Chief Executive Officer and Chief Financial Officer have reviewed and evaluated the effectiveness of the Company's disclosure controls and procedures (as required by Exchange Act Rules 240.13a-15(b) and 15d-14(a)) as of June 30, 2017. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's current disclosure controls and procedures are effective and timely, providing them with material information relating to the Company required to be disclosed in the reports the Company files or submits under the Exchange Act.

#### Changes in Internal Controls

There have not been any 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 six months of 2017, to which this report relates that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

## PART II – OTHER INFORMATION

### Item 1. Legal Proceedings

The Company is involved in various claims, legal actions and complaints which arise in the ordinary course of business. In the Company's opinion, all such matters are adequately covered by insurance, are without merit or are of such kind, or involve such amounts, that unfavorable disposition would not have a material adverse effect on the

financial condition or results of operations of the Company.

Item 1A. Risk Factors

There have been no material changes in our assessment of our risk factors from those set forth in our Annual Report on Form 10-K for the year ended December 31, 2016.

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

Use of Proceeds from Initial Public Offering –On June 16, 2015, the Company completed its initial public offering of 2,657,000 common shares. Additionally, 218,000 common shares were sold by certain selling shareholders. The Company received net proceeds of \$34.9 million from the offering, after deducting the underwriting discounts and offering expenses. The Company did not receive any proceeds from the sale of shares by the selling shareholders.

We plan to utilize a major portion of the offering proceeds in connection with the pending acquisitions of Town & Country Bank, Inc. and Banner Bank's Utah branches.

Item 3. Defaults upon Senior Securities

Not Applicable

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

None

Item 6. Exhibits

| Exhibit<br>Number | Description   |
|-------------------|---|
| 2.1*              | Purchase and Assumption Agreement dated July 26, 2017   |
| 31.1              | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes - Oxley Act of 2002  |
| 31.2              | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes - Oxley Act of 2002  |
| 32                | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes - Oxley Act of 2002   |
| 101               | The following financial information from People's Utah Bancorp Quarterly Report on Form 10-Q for the quarter ended June 30, 2017 is formatted in XBRL: (i) the Unaudited Condensed Consolidated Statements of Financial Condition, (ii) the Unaudited Condensed Consolidated Statements of Operations, (iii) the Unaudited Condensed Consolidated Statements of Stockholders' Equity and Comprehensive Income, (iv) the Unaudited Condensed Consolidated Statements of Cash Flows, and (v) the Notes to Unaudited Condensed Consolidated Financial Statements |

\* Schedules and exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K. The Company agrees to furnish supplementally a copy of any such omitted schedule or exhibit to the SEC upon request.

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 on August 8, 2017

PEOPLE'S UTAH BANCORP

/s/ Richard T. Beard  
Richard T. Beard  
President and Chief Executive Officer

(Principal Executive Officer)

/s/ Wolfgang T.N. Muelleck  
Wolfgang T.N. Muelleck  
Executive Vice President and Chief Financial Officer

(Principal Financial Officer)