GUARANTY BANCSHARES INC /TX/
Form 10-Q
November 09, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018
OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to .
Commission File Number: 001-38087
GUARANTY BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

Texas	75-1656431
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)
201 South Jefferson Avenue Mount Pleasant, Texas	75455
(Address of principal executive offices)	(Zip code)

(888) 572 - 9881
(Registrant's telephone number, including area code)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company
	Emerging growth company

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

of the Exchange Act.

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

As of November 9, 2018, there were 11,889,009 outstanding shares of the registrant’s common stock, par value $1.00 per share.

GUARANTY BANCSHARES, INC.

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

	(Unaudited) September 30, 2018	(Audited) December 31, 2017
ASSETS		
Cash and due from banks	$ 38,483	$ 40,482
Federal funds sold	10,700	26,175
Interest-bearing deposits	4,868	24,771
Total cash and cash equivalents	54,051	91,428
Securities available for sale	232,378	232,372
Securities held to maturity	164,839	174,684
Loans held for sale	826	1,896
Loans, net	1,638,149	1,347,779
Accrued interest receivable	7,760	8,174
Premises and equipment, net	52,660	43,818
Other real estate owned	1,783	2,244
Cash surrender value of life insurance	25,747	19,117
Deferred tax asset	3,237	2,543
Core deposit intangible, net	4,919	2,724
Goodwill	32,160	18,742
Other assets	24,071	17,103
Total assets	$ 2,242,580	$ 1,962,624
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits		
Noninterest-bearing	$ 479,405	$ 410,009
Interest-bearing	1,357,934	1,266,311
Total deposits	1,837,339	1,676,320
Securities sold under agreements to repurchase	11,107	12,879
Accrued interest and other liabilities	10,187	7,117
Federal Home Loan Bank advances	129,140	45,153
Subordinated debentures	12,810	13,810
Total liabilities	2,000,583	1,755,279

See accompanying notes to consolidated financial statements.
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GUARANTY BANCSHARES, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share amounts)

	(Unaudited) September 30, 2018	(Audited) December 31, 2017
Shareholders' equity		
Preferred stock, $5.00 par value, 15,000,000 shares authorized, no shares issued	—	—
Common stock, $1.00 par value, 50,000,000 shares authorized, 12,827,114 and 11,921,298 shares issued, and 11,964,472 and 11,058,956 shares outstanding, respectively	12,827	11,921
Additional paid-in capital	184,781	155,601
Retained earnings	75,590	66,037
Treasury stock, 862,642 and 862,342 shares at cost	(20,096)	(20,087)
Accumulated other comprehensive loss	(11,105)	(6,127)
Total shareholders' equity	241,997	207,345
Total liabilities and shareholders' equity	$ 2,242,580	$ 1,962,624

See accompanying notes to consolidated financial statements.

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GUARANTY BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF EARNINGS (Unaudited)
(Dollars in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Interest income				
Loans, including fees	$20,879	$15,486	$55,377	$45,115
Securities				
Taxable	1,526	1,545	4,713	4,257
Nontaxable	966	919	2,812	2,761
Federal funds sold and interest-bearing deposits	304	215	837	960
Total interest income	23,675	18,165	63,739	53,093
Interest expense				
Deposits	4,670	2,730	11,948	7,761
FHLB advances and federal funds purchased	593	157	1,181	294
Subordinated debentures	173	164	516	559
Other borrowed money	10	12	34	337
Total interest expense	5,446	3,063	13,679	8,951
Net interest income	18,229	15,102	50,060	44,142
Provision for loan losses	500	800	1,750	2,250
Net interest income after provision for loan losses	17,729	14,302	48,310	41,892
Noninterest income				
Service charges	921	986	2,661	2,801
Net realized gain (loss) on securities transactions	1	—	(50)	25
Net realized gain on sale of loans	637	589	1,871	1,490
Other income	1,990	2,127	6,648	6,184
Total noninterest income	3,549	3,702	11,130	10,500
Noninterest expense				
Employee compensation and benefits	8,156	6,729	23,723	20,156
Occupancy expenses	2,217	1,938	6,076	5,552
Other expenses	4,654	3,499	12,431	10,409
Total noninterest expense	15,027	12,166	42,230	36,117
Income before income taxes	6,251	5,838	17,210	16,275
Income tax provision	1,160	1,699	3,126	4,644
Net earnings	$5,091	$4,139	$14,084	$11,631
Basic earnings per share	$0.43	$0.37	$1.23	$1.17
Diluted earnings per share	$0.42	$0.37	$1.22	$1.16

See accompanying notes to consolidated financial statements.

GUARANTY BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)
(Dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net earnings	$5,091	$4,139	$14,084	$11,631
Other comprehensive income:				
Unrealized (losses) gains on securities				
Unrealized holding (losses) gains arising during the period	(1,592)	(264)	(6,104)	2,422
Amortization of net unrealized gains on held to maturity securities	6	23	28	58
Reclassification adjustment for net (gains) losses included in net earnings	(1)	—	50	(25)
Tax effect	334	92	1,271	(839)
Unrealized (losses) gains on securities, net of tax	(1,253)	(149)	(4,755)	1,616
Unrealized holding gains arising during the period on interest rate swaps	67	35	263	29
Total other comprehensive (loss) income	(1,186)	(114)	(4,492)	1,645
Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income	—	—	(486)	—
Comprehensive income	$3,905	$4,025	$9,106	$13,276

See accompanying notes to consolidated financial statements.

GUARANTY BANCSHARES, INC.
CONSOLIDATED STATMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)
(Dollars in thousands, except per share amounts)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Less: KSOP-Owned Shares	Total Shareholders' Equity
For the Nine Months Ended September 30, 2017								
Balance at December 31, 2016	$ —	$ 9,616	$ 101,736	$ 57,160	$ (20,111)	$ (6,487)	$ (31,661)	$ 110,253
Net earnings	—	—	—	11,631	—	—	—	11,631
Other comprehensive income	—	—	—	—	—	1,645	—	1,645
Terminated KSOP put option	—	—	—	—	—	—	34,300	34,300
Exercise of stock options	—	5	55	—	24	—	—	84
Sale of common stock	—	2,300	53,455	—	—	—	—	55,755
Stock based compensation	—	—	247	—	—	—	—	247
Net change in fair value of KSOP shares	—	—	—	—	—	—	(2,639)	(2,639)
Dividends:								
Common - $0.39 per share	—	—	—	(4,013)	—	—	—	(4,013)
Balance at September 30, 2017	$ —	$ 11,921	$ 155,493	$ 64,778	$ (20,087)	$ (4,842)	$ —	$ 207,263
For the Nine Months Ended September 30, 2018								
Balance at December 31, 2017	$ —	$ 11,921	$ 155,601	$ 66,037	$ (20,087)	$ (6,127)	$ —	$ 207,345
Net earnings	—	—	—	14,084	—	—	—	14,084
Other comprehensive loss	—	—	—	—	—	(4,492)	—	(4,492)
Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income	—	—	—	486	—	(486)	—	—
Exercise of stock options	—	6	134	—	—	—	—	140
Purchase of treasury stock	—	—	—	—	(9)	—	—	(9)
Issuance of common stock	—	900	28,668	—	—	—	—	29,568
Stock based compensation	—	—	378	—	—	—	—	378
Dividends:								
Common - $0.43 per share	—	—	—	(5,017)	—	—	—	(5,017)
Balance at September 30, 2018	$ —	$ 12,827	$ 184,781	$ 75,590	$ (20,096)	$ (11,105)	$ —	$ 241,997

See accompanying notes to consolidated financial statements.

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GUARANTY BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(Dollars in thousands)

	For the Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities		
Net earnings	$14,084	$11,631
Adjustments to reconcile net earnings to net cash provided from operating activities:		
Depreciation	2,457	2,385
Amortization	881	782
Deferred taxes	577	(214)
Premium amortization, net of discount accretion	3,247	3,581
Net realized gain on securities transactions	50	(25)
Gain on sale of loans	(1,871)	(1,490)
Provision for loan losses	1,750	2,250
Origination of loans held for sale	(56,276)	(50,230)
Proceeds from loans held for sale	59,217	50,883
Write-down of other real estate and repossessed assets	392	9
Net loss on sale of premises, equipment, other real estate owned and other assets	478	111
Stock based compensation	378	247
Net change in accrued interest receivable and other assets	(5,170)	1,680
Net change in accrued interest payable and other liabilities	1,768	1,624
Net cash provided by operating activities	21,962	23,224
Cash flows from investing activities		
Securities available for sale:		
Purchases	(124,914)	(313,177)
Proceeds from sales	111,813	213,813
Proceeds from maturities and principal repayments	20,697	18,925
Securities held to maturity:		
Proceeds from sales	—	923
Proceeds from maturities and principal repayments	8,184	7,497
Cash paid in connection with acquisitions	(6,423)	—
Cash received from acquired banks	24,927	—
Net purchases of premises and equipment	(2,924)	(1,678)
Net proceeds from sale of premises, equipment, other real estate owned and other assets	1,898	1,830
Net increase in loans	(138,024)	(64,438)
Net cash used in investing activities	(104,766)	(136,305)
Cash flows from financing activities		
Net change in deposits	(20,402)	40,511
Net change in securities sold under agreements to repurchase	(1,772)	2,061
Proceeds from FHLB advances	325,000	60,000
Repayment of FHLB advances	(251,513)	(50,013)
Proceeds from other debt	—	2,000
Repayment of other debt	—	(20,286)
Repayments of debentures	(1,000)	(5,500)

Purchase of treasury stock	(9)	—

See accompanying notes to consolidated financial statements.
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GUARANTY BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(Dollars in thousands)

	For the Nine Months Ended September 30,	
	2018	2017
Exercise of stock options	140	84
Sale of common stock	—	55,755
Cash dividends	(5,017)	(4,013)
Net cash provided by financing activities	45,427	80,599
Net change in cash and cash equivalents	(37,377)	(32,482)
Cash and cash equivalents at beginning of period	91,428	127,543
Cash and cash equivalents at end of period	$54,051	$95,061
Supplemental disclosures of cash flow information		
Interest paid	$13,137	$8,958
Income taxes paid	4,008	4,910
Supplemental schedule of noncash investing and financing activities		
Transfer loans to other real estate owned and repossessed assets	591	992
Common stock issued in acquisitions	29,568	—
Transfer of KSOP shares	—	34,300
Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income	486	—
Net change in fair value of KSOP shares	—	2,639

See accompanying notes to consolidated financial statements.

GUARANTY BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations: Guaranty Bancshares, Inc. ("Guaranty") is a bank holding company headquartered in Mount Pleasant, Texas that provides, through its wholly-owned subsidiary, Guaranty Bank & Trust, N.A. (the "Bank"), a broad array of financial products and services to individuals and corporate customers, primarily in its markets of East Texas, Dallas/Fort Worth, Greater Houston and Central Texas. The terms "the Company," "we," "us" and "our" mean Guaranty and its subsidiaries, when appropriate. The Company's main sources of income are derived from granting loans throughout its markets and investing in securities issued by the U.S. Treasury, U.S. government agencies and state and political subdivisions. The Company's primary lending products are real estate, commercial and consumer loans. Although the Company has a diversified loan portfolio, a substantial portion of its debtors' abilities to honor contracts is dependent on the economy of the State of Texas and primarily the economies of East Texas, Dallas/Fort Worth, Greater Houston and Central Texas. The Company primarily funds its lending activities with deposit operations. The Company's primary deposit products are checking accounts, money market accounts and certificates of deposit.

Basis of Presentation: The consolidated financial statements in this Quarterly Report on Form 10-Q (this "Report") include the accounts of Guaranty, the Bank, and their respective other direct and indirect subsidiaries and any other entities in which Guaranty has a controlling interest. The Bank has six wholly-owned non-bank subsidiaries, Guaranty Company, Inc., G B COM, INC., 2800 South Texas Avenue LLC, Pin Oak Realty Holdings, Inc., Pin Oak Energy Holdings, LLC and White Oak Aviation, LLC. All significant intercompany balances and transactions have been eliminated in consolidation. The accounting and financial reporting policies followed by the Company conform, in all material respects, to accounting principles generally accepted in the United States of America ("GAAP") and to general practices within the financial services industry.
The consolidated financial statements in this Report have not been audited by an independent registered public accounting firm, but in the opinion of management, reflect all adjustments necessary for a fair presentation of the Company's financial position and results of operations. All such adjustments were of a normal and recurring nature. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission ("SEC"). Accordingly, the financial statements do not include all of the information and footnotes required by GAAP for complete financial statements and should be read in conjunction with the Company's consolidated financial statements, and notes thereto, for the year ended December 31, 2017, included in Guaranty's Annual Report on Form 10-K for the year ended December 31, 2017. Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period. All dollar amounts referenced and discussed in the notes to the consolidated financial statements in this Report are presented in thousands, unless noted otherwise.
The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. These estimates and assumptions may also affect disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

KSOP Repurchase Right: In accordance with applicable provisions of the Internal Revenue Code, the terms of Guaranty's employee stock ownership plan with 401(k) provisions ("KSOP"), provided that, for so long as Guaranty was a privately-held company without a public market for its common stock, KSOP participants would have the right, for a specified period of time, to require Guaranty to repurchase shares of its common stock that are distributed to them

by the KSOP. This repurchase obligation terminated upon the consummation of Guaranty's initial public offering and listing of its common stock on the NASDAQ Global Select Market in May 2017. However, because Guaranty was privately-held without a public market for its common stock as of and for the quarter ended March 31, 2017, the shares of common stock held by the KSOP are reflected in the Company's consolidated statement of changes in shareholders' equity for the nine months ended September 30, 2017 in a column called "KSOP-owned shares". As a result of the initial public offering, the consolidated statement of changes in shareholders' equity for the nine months ended September 30, 2017 includes an adjustment for the inclusion of such KSOP-owned shares in total shareholders' equity

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as "terminated KSOP put option." For all periods following Guaranty’s initial public offering and continued listing of the Company’s common stock on the NASDAQ Global Select Market, the KSOP-owned shares are included in, and not deducted from, shareholders’ equity.

Recent Accounting Pronouncements:

In February 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update (“ASU”) 2018-02, Income Statement — Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. ASU 2018-02 was issued to address the income tax accounting treatment of the stranded tax effects within other comprehensive income due to the prohibition of backward tracing due to an income tax rate change that was initially recorded in other comprehensive income. This issue came about from the enactment of the Tax Cuts and Jobs Act on December 22, 2017 that changed the Company’s income tax rate from 35% to 21%. The ASU changed current accounting whereby an entity may elect to reclassify the stranded tax effect from accumulated other comprehensive income to retained earnings. The ASU is effective for periods beginning after December 15, 2018 although early adoption is permitted. The Company adopted ASU 2018-02 in the first quarter of 2018 and reclassified its stranded tax effect of $486 within accumulated other comprehensive income to retained earnings at March 31, 2018.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. This ASU simplifies the accounting for goodwill impairment for all entities by requiring impairment changes to be based on the first step in today’s two-step impairment test, thus eliminating step two from the goodwill impairment test. In addition, the amendment eliminates the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform step two of the goodwill impairment test. For pubic companies, ASU 2017-04 is effective for fiscal years beginning after December 15, 2019 with early adoption permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company is in the process of evaluating the impact of this pronouncement, which is not expected to have a significant impact on its consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which sets forth a "current expected credit loss" ("CECL") model requiring the Company to measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions and reasonable supportable forecasts. This replaces the existing incurred loss model and is applicable to the measurement of credit losses on financial assets measured at amortized cost and applies to some off-balance sheet credit exposures. For public companies, the amendments in this update are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company has assembled a transition team to assess the adoption of this ASU, and has developed a project plan regarding implementation.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The FASB issued this ASU to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet by lessees for those leases classified as operating leases under current U.S. GAAP and disclosing key information about leasing arrangements. The amendments in this ASU are effective for public companies for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. Early adoption of this ASU is permitted for all entities. We expect recorded assets and liabilities to increase upon adoption of the standard as it relates to operating leases in which we are the lessee.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities, which is intended to improve the recognition and measurement of financial instruments by requiring: equity investments (other than equity method or consolidation) to be measured at fair value with changes in fair value recognized in net income; public business entities to use the exit price notion

when measuring the fair value of financial instruments for disclosure purposes; separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; eliminating the requirement to disclose the fair value of financial instruments measured at amortized cost for organizations that are not public business entities;

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eliminating the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; and requiring a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk (also referred to as "own credit") when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. The adoption of ASU 2016-01 on January 1, 2018 did not have a material impact on the Company's condensed consolidated financial statements. In accordance with (iv) above, the Company measured the fair value of its loan portfolio prospectively as of June 30, 2018 using an exit price notion. See Note 13 – Fair Value for further information regarding the valuation of these loans.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (ASU 606), followed by various amendments to the standard, including clarification of principal versus agent considerations, narrow scope improvements and other technical corrections, all of which are codified in ASU 606. The amendments in these updates amend existing guidance related to revenue from contracts with customers. The amendments supersede and replace nearly all existing revenue recognition guidance, including industry-specific guidance, establish a new control-based revenue recognition model, change the basis for deciding when revenue is recognized over a time or point in time, provide new and more detailed guidance on specific topics and expand and improve disclosures about revenue. In addition, these amendments specify the accounting for some costs to obtain or fulfill a contract with a customer. The Company has applied ASU 2014-09, which was effective on January 1, 2018, using the modified retrospective approach to all existing contracts with customers covered under the scope of the standard. The adoption of this ASU was not significant to the Company and had no material effect on how the Company recognizes revenue nor did it result in a cumulative effect adjustment or any presentation changes to the consolidated financial statements. The majority of the Company's revenue-generating transactions are not subject to ASC 606, including revenue generated from financial instruments, such as loans, letters of credit, loan processing fees and investment securities, as well as revenue related to mortgage banking activities, and BOLI, as these activities are subject to other accounting guidance. Descriptions of revenue-generating activities that are within the scope of ASC 606, and are presented in the accompanying Consolidated Statements of Income as components of noninterest income, are as follows:

- Deposit services. Service charges on deposit accounts include fees for banking services provided, overdrafts and non-sufficient funds. Revenue is generally recognized in accordance with published deposit account agreements for retail accounts or contractual agreements for commercial accounts.
- Merchant and debit card fees. Merchant and debit card fees includes interchange income that is generated by our customers' usage and volume of activity. Interchange rates are not controlled by the Company, which effectively acts as processor that collects and remits payments associated with customer debit card transactions. Merchant service revenue is derived from third party vendors that process credit card transactions on behalf of our merchant customers. Merchant services revenue is primarily comprised of residual fee income based on the referred merchant's processing volumes and/or margin.
- Fiduciary income. Trust income includes fees and commissions from investment management, administrative and advisory services primarily for individuals, and to a lesser extent, partnerships and corporations. Revenue is recognized on an accrual basis at the time the services are performed and when we have a right to invoice and are based on either the market value of the assets managed or the services provided.
- Other noninterest income. Other noninterest income includes among other things, mortgage loan origination fees, wire transfer fees, stop payment fees, loan administration fees and mortgage warehouse lending fees. The majority of these fees in other noninterest income are not subject to the requirements of ASC 606. Fees that are within the scope of ASC 606 are generally received at the time the performance obligations are met.

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13.

NOTE 2 - ACQUISITIONS

On close of business June 1, 2018, the Company acquired 100% of the outstanding shares of capital stock of Westbound Bank, a Texas banking association ("Westbound"), in exchange for a combination of cash and shares of the Company's common stock amounting to total consideration of $35,991. Under the terms of the acquisition, the Company issued 899,816 shares of the Company's common stock in exchange for 2,311,952 shares of Westbound, representing 100% of the outstanding shares of common and preferred stock of Westbound. With the acquisition, the Company has expanded its market into the Houston metropolitan region. Results of operations of the acquired company were included in the Company's results beginning June 2, 2018. Acquisition-related costs of $1,101 and $365 are included in other operating expenses in the Company's consolidated statement of earnings for the nine and three months ended September 30, 2018, respectively. The fair value of the common shares issued as part of the consideration paid for Westbound was determined based upon the closing price of the Company's common shares on the acquisition date.

Goodwill of $13,418 arising from the acquisition of Westbound consisted largely of synergies and the cost savings resulting from the combining of the operations of the companies. None of the goodwill is expected to be deductible for income tax purposes. The following table summarizes the consideration paid for Westbound and the fair value of the assets acquired and liabilities assumed recognized at the acquisition date:

Consideration:

	Westbound
Cash	$ 6,423
Equity instruments	29,568
Fair Value of total consideration transferred	$ 35,991

Cash consideration includes contingent consideration related to an escrow agreement in which $1,750 was retained from amounts paid to Westbound shareholders for payment to Guaranty in the event that certain defined loan relationships experienced actual losses during the three year period following the close of the transaction on June 1, 2018. If the loans defined in the escrow agreement do experience losses, funds from the escrow account will be remitted to Guaranty. If the loans payoff or do not experience losses, funds from the escrow account will be remitted to Westbound shareholders according to terms set forth in the escrow agreement.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition, June 1, 2018.

	Westbound
Cash and due from banks	$ 24,927
Investment securities available for sale	15,264
Loans, net of discount	154,687
Accrued interest receivable	651
Premises and equipment	8,625
Nonmarketable equity securities	—
Core deposit intangible	2,700
Other assets	9,205
Total assets acquired	216,059
Non-interest bearing deposits	40,595
Interest bearing deposits	140,826
Federal Home Loan Bank advances	10,500
Accrued interest and other liabilities	1,565
Total liabilities assumed	193,486
Net assets acquired	22,573
Total consideration paid	35,991
Goodwill	$ 13,418

The fair value of net assets acquired includes fair value adjustments to certain receivables that were not considered impaired as of the acquisition date (“acquired performing loans”). The fair value adjustments were determined using discounted contractual cash flows. However, the Company believes that all contractual cash flows related to these financial instruments will be collected. As such, these receivables were not considered impaired at the acquisition date and were not subject to the guidance relating to purchased credit impaired loans, which have shown evidence of credit deterioration since origination. Acquired performing loans had fair value and gross contractual amounts receivable of $154,687.

NOTE 3 - MARKETABLE SECURITIES

The following tables summarize the amortized cost and fair value of securities available for sale and securities held to maturity as of September 30, 2018 and December 31, 2017 and the corresponding amounts of gross unrealized gains and losses:

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September 30, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available for sale:				
Corporate bonds	$ 19,762	$ —	$ 648	$ 19,114
Municipal securities	15,814	—	451	15,363
Mortgage-backed securities	91,208	—	4,447	86,761
Collateralized mortgage obligations	115,125	—	3,985	111,140
Total available for sale	$ 241,909	$ —	$ 9,531	$ 232,378
Held to maturity:				
Municipal securities	$ 142,419	$ 710	$ 2,420	$ 140,709
Mortgage-backed securities	17,871	77	611	17,337
Collateralized mortgage obligations	4,549	46	45	4,550
Total held to maturity	$ 164,839	$ 833	$ 3,076	$ 162,596

December 31, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available for sale:				
Corporate bonds	$ 18,823	$ 64	$ 50	$ 18,837
Municipal securities	7,746	—	200	7,546
Mortgage-backed securities	92,471	—	1,793	90,678
Collateralized mortgage obligations	116,809	5	1,503	115,311
Total available for sale	$ 235,849	$ 69	$ 3,546	$ 232,372
Held to maturity:				
Municipal securities	$ 146,496	$ 2,244	$ 218	$ 148,522
Mortgage-backed securities	22,026	199	230	21,995
Collateralized mortgage obligations	6,162	111	—	6,273
Total held to maturity	$ 174,684	$ 2,554	$ 448	$ 176,790

Management evaluates securities for other-than-temporary impairment (“OTTI”) on at least a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The Company did not record any OTTI losses on any of its securities during the nine months ended September 30, 2018 or for the year ended December 31, 2017.

Information pertaining to securities with gross unrealized losses as of September 30, 2018 and December 31, 2017 aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position is detailed in the following tables:

	Less Than 12 Months		12 Months or Longer		Total	
September 30, 2018	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value
Available for sale:						
Corporate bonds	$(648)	$19,114	$—	$—	$(648)	$19,114
Municipal securities	(65)	7,557	(386)	7,289	(451)	14,846
Mortgage-backed securities	(469)	15,439	(3,978)	71,322	(4,447)	86,761
Collateralized mortgage obligations	(2,126)	68,879	(1,859)	42,261	(3,985)	111,140
Total available for sale	$(3,308)	$110,989	$(6,223)	$120,872	$(9,531)	$231,861
Held to maturity:						
Municipal securities	$(1,633)	$75,935	$(787)	$20,088	$(2,420)	$96,023
Mortgage-backed securities	(232)	6,236	(379)	8,004	(611)	14,240
Collateralized mortgage obligations	(45)	2,363	—	—	(45)	2,363
Total held to maturity	$(1,910)	$84,534	$(1,166)	$28,092	$(3,076)	$112,626

	Less Than 12 Months		12 Months or Longer		Total	
December 31, 2017	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value
Available for sale:						
Corporate bonds	$(50)	$8,019	$—	$—	$(50)	$8,019
Municipal securities	—	—	(200)	7,546	(200)	7,546
Mortgage-backed securities	(658)	42,881	(1,135)	47,797	(1,793)	90,678
Collateralized mortgage obligations	(1,091)	93,584	(412)	21,258	(1,503)	114,842
Total available for sale	$(1,799)	$144,484	$(1,747)	$76,601	$(3,546)	$221,085
Held to maturity:						
Municipal securities	$(37)	$9,230	$(181)	$19,961	$(218)	$29,191
Mortgage-backed securities	(57)	6,499	(173)	9,747	(230)	16,246
Collateralized mortgage obligations	—	—	—	—	—	—
Total held to maturity	$(94)	$15,729	$(354)	$29,708	$(448)	$45,437

The number of investment positions in an unrealized loss position totaled 203 at September 30, 2018. The securities in a loss position were composed of tax-exempt municipal bonds, corporate bonds, collateralized mortgage obligations and mortgage backed securities. Management believes the unrealized loss on the remaining securities is a function of the movement of interest rates since the time of purchase. Based on evaluation of available evidence, including recent changes in interest rates, credit rating information and information obtained from regulatory filings, management

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believes the declines in fair value for these securities are temporary. Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment would be reduced and the resulting loss recognized in net income in the period the OTTI is identified. The Company does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery. The Company does not consider these securities to be OTTI at September 30, 2018.
Mortgage-backed securities and collateralized mortgage obligations are backed by pools of mortgages that are insured or guaranteed by the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association or the Government National Mortgage Association.

As of September 30, 2018, there were no holdings of securities of any one issuer, other than the U.S. government and its agencies, in an amount greater than 10% of shareholders' equity.

Securities with fair values of approximately $233,559 and $245,600 at September 30, 2018 and December 31, 2017, respectively, were pledged to secure public fund deposits and for other purposes as required or permitted by law.

The proceeds from sales of available for sale securities and the associated gains and losses are listed below for:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Proceeds from sales	$102,356	$199,974	$111,813	$214,736
Gross gains	4	—	4	38
Gross losses	(3)	—	(54)	(13)

During the nine months ended September 30, 2017, the Company sold three held-to-maturity municipal securities. The Company sold these municipal securities based upon internal credit analysis, under the belief that they had experienced significant deterioration in creditworthiness. The risk exposure presented by these municipalities had increased beyond acceptable levels, and the Company determined that it was reasonably possible that all amounts due would not be collected. The credit analysis determined that the municipalities had been significantly impacted because their tax bases are heavily reliant on the energy industry relative to other sectors of the economy. Specifically, the revenues of these municipalities have been adversely impacted by the significant decline in energy prices since 2014. The Company believes the sale of these securities were merited and permissible under the applicable accounting guidelines because of the significant deterioration in the creditworthiness of the issuers.

There were no held to maturity securities sold during the three or nine months ended September 30, 2018. Sale of securities held to maturity were as follows for:

	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2017
Proceeds from sales	$ —	$ 923
Amortized cost	—	907
Gross realized gains	—	16

Tax expense related to securities gains/losses	—	(4)

The contractual maturities at September 30, 2018 of available for sale and held to maturity securities at carrying value and estimated fair value are shown below. The Company invests in mortgage-backed securities and collateralized mortgage obligations that have expected maturities that differ from their contractual maturities. These differences arise because borrowers and/or issuers may have the right to call or prepay their obligation with or without call or prepayment penalties.

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September 30, 2018	Available for Sale		Held to Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due within one year	$—	$—	$769	$768
Due after one year through five years	11,234	10,926	19,153	19,244
Due after five years through ten years	16,668	16,262	42,448	42,774
Due after ten years	7,674	7,289	80,049	77,923
Mortgage-backed securities	91,208	86,761	17,871	17,337
Collateralized mortgage obligations	115,125	111,140	4,549	4,550
Total Securities	$241,909	$232,378	$164,839	$162,596

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NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES

The following table summarizes the Company’s loan portfolio by type of loan as of:

	September 30, 2018	December 31, 2017
Commercial and industrial	$ 248,758	$ 197,508
Real estate:		
Construction and development	229,307	196,774
Commercial real estate	599,153	418,137
Farmland	65,209	59,023
1-4 family residential	392,456	374,371
Multi-family residential	38,523	36,574
Consumer	53,947	51,267
Agricultural	24,184	25,596
Overdrafts	326	294
Total loans	1,651,863	1,359,544
Net of:		
Deferred loan fees	727	1,094
Allowance for loan losses	(14,441)	(12,859)
Total net loans	$ 1,638,149	$ 1,347,779

The following tables present the activity in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method for the nine months ended September 30, 2018, for the year ended December 31, 2017 and for the nine months ended September 30, 2017:

For the Nine Months Ended September 30, 2018	Commercial and industrial	Construction and development	Commercial real estate	Farmland	1-4 family residential	Multi-family residential	Consumer	Agricultural	Overdrafts	Total
Allowance for loan losses:										
Beginning balance	$1,581	$1,724	$4,585	$523	$3,022	$629	$602	$187	$6	$12,859
Provision for loan losses	138	119	1,329	100	(161)	41	101	(3)	86	1,750
Loans charged-off	(66)	—	(32)	—	(19)	—	(175)	(2)	(117)	(411)
Recoveries	54	—	—	—	49	—	41	65	34	243
Ending balance	$1,707	$1,843	$5,882	$623	$2,891	$670	$569	$247	$9	$14,441
Allowance ending balance:										

Individually evaluated for impairment	$315	$—	$61	$74	$4	$—	$—	$—	$—	$454
Collectively evaluated for impairment	1,392	1,843	5,821	549	2,887	670	569	247	9	13,987
Ending balance	$1,707	$1,843	$5,882	$623	$2,891	$670	$569	$247	$9	$14,441
Loans:										
Individually evaluated for impairment	$1,584	$1,684	$6,360	$218	$1,571	$—	$—	$409	$—	$11,826
Collectively evaluated for impairment	247,174	227,623	592,793	64,991	390,885	38,523	53,947	23,775	326	1,640,037
Ending balance	$248,758	$229,307	$599,153	$65,209	$392,456	$38,523	$53,947	$24,184	$326	$1,651,863

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For the year ended December 31, 2017	Commercial and industrial	Construction and development	Commercial real estate	Farmland	1-4 family residential	Multi-family residential	Consumer	Agricultural	Overdrafts	Total
Allowance for loan losses:										
Beginning balance	$1,592	$1,161	$3,264	$482	$3,960	$281	$585	$153	$6	$11,484
Provision for loan losses	272	563	1,405	41	(418)	348	253	276	110	2,850
Loans charged-off	(1,080)	—	(84)	—	(543)	—	(344)	(242)	(165)	(2,458)
Recoveries	797	—	—	—	23	—	108	—	55	983
Ending balance	$1,581	$1,724	$4,585	$523	$3,022	$629	$602	$187	$6	$12,859
Allowance ending balance:										
Individually evaluated for impairment	$17	$—	$27	$85	$5	$—	$—	$—	$—	$134
Collectively evaluated for impairment	1,564	1,724	4,558	438	3,017	629	602	187	6	12,725
Ending balance	$1,581	$1,724	$4,585	$523	$3,022	$629	$602	$187	$6	$12,859
Loans:										
Individually evaluated for impairment	$463	$—	$4,258	$163	$842	$217	$—	$397	$—	$6,340
Collectively evaluated for impairment	197,045	196,774	413,879	58,860	373,529	36,357	51,267	25,199	294	1,353,204
Ending balance	$197,508	$196,774	$418,137	$59,023	$374,371	$36,574	$51,267	$25,596	$294	$1,359,544

For the Nine Months Ended September 30, 2017	Commercial and industrial	Construction and development	Commercial real estate	Farmland	1-4 family residential	Multi-family residential	Consumer	Agricultural	Overdrafts	Total
Allowance for loan losses:										

Beginning balance	$1,592	$1,161	$3,264	$482	$3,960	$281	$585	$153	$6	$11,484
Provision for loan losses	602	762	1,019	(24)	(585)	(15)	149	258	84	2,250
Loans charged-off	(737)	—	(84)	—	(307)	—	(230)	(4)	(117)	(1,479)
Recoveries	116	—	—	—	21	—	95	—	41	273
Ending balance	$1,573	$1,923	$4,199	$458	$3,089	$266	$599	$407	$14	$12,528
Allowance ending balance:										
Individually evaluated for impairment	$19	$—	$31	$85	$145	$—	$—	$240	$—	$520
Collectively evaluated for impairment	1,554	1,923	4,168	373	2,944	266	599	167	14	12,008
Ending balance	$1,573	$1,923	$4,199	$458	$3,089	$266	$599	$407	$14	$12,528
Loans:										
Individually evaluated for impairment	$354	$—	$4,029	$276	$1,097	$228	$—	$696	$—	$6,680
Collectively evaluated for impairment	192,309	201,067	389,285	54,073	364,792	23,007	51,711	23,753	698	1,300,695
Ending balance	$192,663	$201,067	$393,314	$54,349	$365,889	$23,235	$51,711	$24,449	$698	$1,307,375

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GUARANTY BANCSHARES, INC.
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Credit Quality
The Company closely monitors economic conditions and loan performance trends to manage and evaluate the exposure to credit risk. Key factors tracked by the Company and utilized in evaluating the credit quality of the loan portfolio include trends in delinquency ratios, the level of nonperforming assets, borrower's repayment capacity, and collateral coverage.

Assets are graded "pass" when the relationship exhibits acceptable credit risk and indicates repayment ability, tolerable collateral coverage and reasonable performance history. Lending relationships exhibiting potentially significant credit risk and marginal repayment ability and/or asset protection are graded "special mention." Assets classified as "substandard" are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness that jeopardizes the liquidation of the debt. Substandard graded loans are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Assets graded "doubtful" are substandard graded loans that have added characteristics that make collection or liquidation in full improbable. The Company typically measures impairment based on the present value of expected future cash flows, discounted at the loan's effective interest rate, or based on the loan's observable market price or the fair value of the collateral if the loan is collateral-dependent.

The following tables summarize the credit exposure in the Company's consumer and commercial loan portfolios as of:

September 30, 2018	Commercial and industrial	Construction and development	Commercial real estate	Farmland	1-4 family residential	Multi-family residential	Consumer and Overdrafts	Agricultural	Total
Grade:									
Pass	$ 246,621	$ 227,862	$ 587,603	$ 64,797	$ 391,556	$ 37,284	$ 54,183	$ 23,605	$ 1,633,511
Special mention	807	—	5,165	50	293	1,239	45	130	7,729
Substandard	1,330	1,445	6,385	362	607	—	45	449	10,623
Total	$ 248,758	$ 229,307	$ 599,153	$ 65,209	$ 392,456	$ 38,523	$ 54,273	$ 24,184	$ 1,651,863

December 31, 2017	Commercial and industrial	Construction and development	Commercial real estate	Farmland	1-4 family residential	Multi-family residential	Consumer and Overdrafts	Agricultural	Total
Grade:									
Pass	$ 196,890	$ 196,515	$ 412,488	$ 58,623	$ 373,154	$ 16,073	$ 51,409	$ 24,650	$ 1,329,802
Special mention	348	259	1,135	226	442	20,284	65	454	23,213
Substandard	270	—	4,514	174	775	217	87	492	6,529
Total	$ 197,508	$ 196,774	$ 418,137	$ 59,023	$ 374,371	$ 36,574	$ 51,561	$ 25,596	$ 1,359,544

(Continued)

The following tables summarize the payment status of loans in the Company's total loan portfolio, including an aging of delinquent loans, loans 90 days or more past due continuing to accrue interest and loans classified as nonperforming as of:

September 30, 2018	30 to 59 Days Past Due	60 to 89 Days Past Due	90 Days and Greater Past Due	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
Commercial and industrial	$ 450	$ 516	$ 489	$ 1,455	$ 247,303	$ 248,758	$ —
Real estate:							
Construction and development	94	56	501	651	228,656	229,307	—
Commercial real estate	1,590	3,311	85	4,986	594,167	599,153	—
Farmland	348	78	45	471	64,738	65,209	—
1-4 family residential	3,640	324	606	4,570	387,886	392,456	—
Multi-family residential	—	—	—	—	38,523	38,523	—
Consumer	418	47	45	510	53,437	53,947	—
Agricultural	—	—	—	—	24,184	24,184	—
Overdrafts	—	—	—	—	326	326	—
Total	$ 6,540	$ 4,332	$ 1,771	$ 12,643	$ 1,639,220	$ 1,651,863	$ —

December 31, 2017	30 to 59 Days Past Due	60 to 89 Days Past Due	90 Days and Greater Past Due	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
Commercial and industrial	$ 1,273	$ 93	$ 17	$ 1,383	$ 196,125	$ 197,508	$ —
Real estate:							
Construction and development	117	—	—	117	196,657	196,774	—
Commercial real estate	192	265	1,067	1,524	416,613	418,137	—
Farmland	139	—	6	145	58,878	59,023	—
1-4 family residential	3,998	416	800	5,214	369,157	374,371	—
Multi-family residential	—	—	217	217	36,357	36,574	—
Consumer	381	69	87	537	50,730	51,267	—
Agricultural	204	2	—	206	25,390	25,596	—
Overdrafts	—	—	—	—	294	294	—
Total	$ 6,304	$ 845	$ 2,194	$ 9,343	$ 1,350,201	$ 1,359,544	$ —

The following table presents information regarding nonaccrual loans as of:

	September 30, 2018	December 31, 2017
Commercial and industrial	$ 565	$ 77
Real estate:		
Commercial real estate	3,908	1,422
Farmland	190	163
1-4 family residential	2,867	1,937
Multi-family residential	—	217

Consumer	96	138
Agricultural	—	50
Total	$ 8,657	$ 4,004

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Impaired Loans and Troubled Debt Restructurings
A troubled debt restructuring ("TDR") is a restructuring in which a bank, for economic or legal reasons related to a borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due from the borrower in accordance with original contractual terms of the loan. Loans with insignificant delays or insignificant short falls in the amount of payments expected to be collected are not considered to be impaired. Loans defined as individually impaired, based on applicable accounting guidance, include larger balance nonperforming loans and TDRs.

The outstanding balances of TDRs are shown below:

	September 30, 2018	December 31, 2017
Nonaccrual TDRs	$ —	$ —
Performing TDRs	727	657
Total	$ 727	$ 657
Specific reserves on TDRs	$ 11	$ 17

The following tables present loans by class modified as TDRs that occurred during the nine months ended September 30, 2018, the twelve months ended December 31, 2017 and the nine months ended September 30, 2017:

Nine Months Ended September 30, 2018	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
1-4 family residential	1	$ 15	$ 15
Farmland	1	78	78
Total	2	$ 93	$ 93

There were no TDRs that have subsequently defaulted through September 30, 2018. The TDRs described above did not increase the allowance for loan losses and resulted in no charge-offs during the nine months ended September 30, 2018.

Year Ended December 31, 2017	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Commercial and industrial	2	$ 381	$ 364
1-4 family residential	1	11	11
Total	3	$ 392	$ 375

There were no TDRs that have subsequently defaulted through December 31, 2017. The TDRs described above did not increase the allowance for loan losses and resulted in no charge-offs during the year ended December 31, 2017.

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Nine Months Ended September 30, 2017	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Commercial and industrial	1	$ 34	$ 15
1-4 family residential	1	11	11
Total	2	$ 45	$ 26

There were no TDRs that subsequently defaulted through September 30, 2017. The TDRs described above increase the allowance for loan losses and resulted in no charge-offs during the nine months ended September 30, 2017.

The following table presents information about the Company's impaired loans as of:

September 30, 2018	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment
With no related allowance recorded:				
Commercial and industrial	$ 786	$ 786	$ —	$ 889
Real estate:				
Construction and development	1,684	1,684	—	334
Commercial real estate	5,399	5,399	—	4,863
Farmland	73	73	—	67
1-4 family residential	1,466	1,466	—	1,077
Multi-family residential	—	—	—	71
Agricultural	409	409	—	472
Subtotal	9,817	9,817	—	7,773
With allowance recorded:				
Commercial and industrial	798	798	315	252
Real estate:				
Commercial real estate	961	961	61	470
Farmland	145	145	74	149
1-4 family residential	105	105	4	129
Agricultural	—	—	—	70
Subtotal	2,009	2,009	454	1,070
Total	$ 11,826	$ 11,826	$ 454	$ 8,843

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The following table presents information about the Company's impaired loans as of:

December 31, 2017	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment
With no related allowance recorded:				
Commercial and industrial	$ 437	$ 437	$ —	$ 434
Real estate:				
Construction and development	—	—	—	311
Commercial real estate	3,979	3,979	—	4,230
Farmland	6	6	—	90
1-4 family residential	681	681	—	1,096
Multi-family residential	217	217	—	180
Consumer	—	—	—	61
Agricultural	397	397	—	384
Subtotal	5,717	5,717	—	6,786
With allowance recorded:				
Commercial and industrial	26	26	17	315
Real estate:				
Construction and development	—	—	—	7
Commercial real estate	279	279	27	505
Farmland	157	157	85	131
1-4 family residential	161	161	5	754
Multi-family residential	—	—	—	19
Consumer	—	—	—	42
Agricultural	—	—	—	180
Subtotal	623	623	134	1,953
Total	$ 6,340	$ 6,340	$ 134	$ 8,739

During the nine months ended September 30, 2018 and 2017, total interest income and cash-based interest income recognized on impaired loans was minimal.

NOTE 5 - SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE AND OTHER DEBT

At September 30, 2018 and December 31, 2017, securities sold under agreements to repurchase totaled $11,107 and $12,879, respectively.

The Company has a $25,000 revolving line of credit, which had no outstanding balance at quarter end, bears interest at the prime rate, with interest payable quarterly, and matures in March 2019.

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Federal Home Loan Bank (FHLB) advances, as of September 30, 2018, were as follows:

Fixed rate advances, with monthly interest payments, principal due in:

Year	Current Weighted Average Rate		Principal Due
2018	2.21	%	$80,000
2019	2.36	%	39,500
2020	2.09	%	6,500
2021	1.87	%	1,500
2022	1.99	%	1,500
			$129,000

Fixed rate advances, with monthly principal and interest payments, principal due in:

Year	Current Weighted Average Rate		Principal Due
2021	1.38	%	140
			$129,140

(Continued)

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NOTE 6 - SUBORDINATED DEBENTURES

Subordinated debentures are made up of the following as of:

	September 30, 2018	December 31, 2017
Trust II Debentures	$ 3,093	$ 3,093
Trust III Debentures	2,062	2,062
DCB Trust I Debentures	5,155	5,155
Other debentures	2,500	3,500
	$ 12,810	$ 13,810

The Company has three trusts, Guaranty (TX) Capital Trust II ("Trust II"), Guaranty (TX) Capital Trust III ("Trust III"), and DCB Financial Trust I ("DCB Trust I") ("Trust II", "Trust III" and together with "DCB Trust I," the "Trusts"). Upon formation, the Trusts issued pass-through securities ("TruPS") with a liquidation value of $1,000 per share to third parties in private placements. Concurrently with the issuance of the TruPS, the Trusts issued common securities to the Company. The Trusts invested the proceeds of the sales of securities to the Company ("Debentures"). The Debentures mature approximately 30 years after the formation date, which may be shortened if certain conditions are met (including the Company having received prior approval of the Federal Reserve and any other required regulatory approvals).

	Trust II	Trust III	DCB Trust I
Formation date	October 30, 2002	July 25, 2006	March 29, 2007
Capital trust pass-through securities			
Number of shares	3,000	2,000	5,000
Original liquidation value	$ 3,000	$ 2,000	$ 5,000
Common securities liquidation value	93	62	155

The securities held by the Trusts qualify as Tier 1 capital for the Company under Federal Reserve Board guidelines. The Federal Reserve's guidelines restrict core capital elements (including trust preferred securities and qualifying perpetual preferred stock) to 25% of all core capital elements, net of goodwill less any associated deferred tax liability. Because the Company's aggregate amount of trust preferred securities is less than the limit of 25% of Tier 1 capital, net of goodwill, the full amount is includable in Tier 1 capital at September 30, 2018 and December 31, 2017. Additionally, the terms provide that trust preferred securities would no longer qualify for Tier 1 capital within five years of their maturity, but would be included as Tier 2 capital. However, the trust preferred securities would be amortized out of Tier 2 capital by one-fifth each year and excluded from Tier 2 capital completely during the year prior to maturity of the junior subordinated debentures.

With certain exceptions, the amount of the principal and any accrued and unpaid interest on the Debentures are subordinated in right of payment to the prior payment in full of all senior indebtedness of the Company. Interest on the Debentures is payable quarterly. The interest is deferrable on a cumulative basis for up to five consecutive years following a suspension of dividend payments on all other capital stock. No principal payments are due until maturity for each of the Debentures.

	Trust II Debentures	Trust III Debentures	DCB Trust I Debentures
Original amount	$ 3,093	$ 2,062	$ 5,155
Maturity date	October 30, 2032	October 1, 2036	June 15, 2037
Interest due	Quarterly	Quarterly	Quarterly

(Continued)

In accordance with ASC 810, "Consolidation," the junior subordinated debentures issued by the Company to the subsidiary trusts are shown as liabilities in the consolidated balance sheets and interest expense associated with the junior subordinated debentures is shown in the consolidated statements of earnings.

Trust II Debentures
Interest is payable at a variable rate per annum, reset quarterly, equal to 3 month LIBOR plus 3.35%.

On any interest payment date on or after October 30, 2012 and prior to maturity date, the debentures are redeemable for cash at the option of the Company, on at least 30, but not more than 60 days' notice, in whole or in part, at a redemption price equal to 100% of the principal amount to be redeemed, plus accrued interest to the date of redemption.

Trust III Debentures
Interest is payable at a variable rate per annum, reset quarterly, equal to 3 month LIBOR plus 1.67%.

On any interest payment date on or after October 1, 2016 and prior to maturity date, the debentures are redeemable for cash at the option of the Company, on at least 30, but not more than 60 days' notice, in whole or in part, at a redemption price equal to 100% of the principal amount to be redeemed, plus accrued interest to the date of redemption.

DCB Trust I Debentures
Interest is payable at a variable rate per annum, reset quarterly, equal to 3 month LIBOR plus 1.80%.

On any interest payment date on or after June 15, 2012 and prior to maturity date, the debentures are redeemable for cash at the option of the Company, on at least 30, but not more than 60 days' notice, in whole or in part, at a redemption price equal to 100% of the principal amount to be redeemed, plus accrued interest to the date of redemption.

Other debentures
In July 2015, the Company issued $4,000 in debentures, of which $3,000 were issued to directors and other related parties. The $3,000 of debentures to related parties were repaid in May 2017 and a $500 par value debenture, which carried a rate of 2.5%, matured and was repaid in July 2017. The remaining $500 debenture has a rate of 4.00% and a maturity date of January 1, 2019. At the Company's option, and with 30 days advanced notice to the holder, the entire principal amount and all accrued interest may be paid to the holder on or before the due date of any debenture. The redemption price is equal to 100% of the face amount of the debenture redeemed, plus all accrued interest.

In December 2015, the Company issued $5,000 in debentures, of which $2,500 were issued to directors and other related parties. In May 2017, $2,000 of the related party debentures were repaid with a portion of the proceeds of Guaranty's initial public offering. A further $1,000 of other debentures matured and were paid off in full in July of this year. The remaining $2,000 of debentures were issued at par value of $500 each with rates ranging from 3.50% to 5.00% and maturity dates from December 31, 2018 to July 1, 2020. At the Company's option, and with 30 days advanced notice to the holder, the entire principal amount and all accrued interest may be paid to the holder on or before the due date of any debenture. The redemption price is equal to 100% of the face amount of the debenture redeemed, plus all accrued interest.

(Continued)

NOTE 7 - STOCK OPTIONS

The Company's 2015 Equity Incentive Plan (the "Plan") which was adopted by the Company and approved by its shareholders in April 2015, amended and restated the Company's 2014 Stock Option Plan. The maximum number of shares of common stock that may be issued pursuant to stock-based awards under the Plan equals 1,000,000 shares, all of which may be subject to incentive stock option treatment. Option awards are generally granted with an exercise price equal to the market price of the Company's common stock at the date of grant. Currently outstanding option awards have vesting periods ranging from 5 to 10 years and have 10-year contractual terms.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. Expected volatilities are based on historical volatilities of the Company's common stock and similar peer group averages. The Company uses historical data to estimate option exercise and post-vesting termination behavior. The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding, which takes in to account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on U.S. Treasury yield curve in effect at the time of the grant.

A summary of activity in the Plan during the nine months ended September 30, 2018 and 2017 follows:

Nine Months Ended September 30, 2018	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life in Years	Aggregate Intrinsic Value
Outstanding at beginning of year	471,442	$ 24.98	7.30	$ 2,696
Granted	90,000	32.59	9.72	—
Exercised	(6,000)	23.33	5.98	41
Forfeited	(11,800)	23.41	5.74	81
Balance, September 30, 2018	543,642	$ 26.29	7.10	$ 2,393
Exercisable at end of period	172,143	$ 24.16	5.79	$ 1,053

Nine Months Ended September 30, 2017	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life in Years	Aggregate Intrinsic Value
Outstanding at beginning of year	340,377	$ 23.43	7.34	$ 194
Granted	150,598	27.64	9.62	657
Exercised	(7,033)	11.94	4.48	141
Forfeited	(6,000)	23.17	7.13	53
Balance, September 30, 2017	477,942	$ 24.93	7.57	$ 3,376
Exercisable at end of period	98,044	$ 23.45	6.17	$ 838

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A summary of nonvested activity in the Plan during the nine months ended September 30, 2018 and 2017 follows:

Nine Months Ended September 30, 2018	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life in Years	Aggregate Intrinsic Value
Outstanding at beginning of year	336,798	$ 25.54	7.88	$ 1,747
Granted	90,000	32.59	9.72	—
Vested	(45,899)	25.64	7.93	228
Forfeited	(9,400)	23.41	5.74	81
Balance, September 30, 2018	371,499	$ 27.28	7.70	$ 1,340

Nine Months Ended September 30, 2017	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life in Years	Aggregate Intrinsic Value
Outstanding at beginning of year	250,700	$ 23.73	7.65	$ 69
Granted	150,598	27.64	9.62	657
Vested	(17,400)	23.13	7.91	154
Forfeited	(4,000)	23.17	7.13	53
Balance, September 30, 2017	379,898	$ 25.31	7.93	$ 2,538

Information related to the Plan is as follows for the nine months ended:

	September 30, 2018	September 30, 2017
Intrinsic value of options exercised	$ 41	$ 141
Cash received from options exercised	140	84
Weighted average fair value of options granted	5.62	5.40

As of September 30, 2018, there was $1,997 of total unrecognized compensation expense related to unvested stock options granted under the Plan. The expense is expected to be recognized over a weighted-average period of 3.93 years.

The Company granted options under the Plan during the first nine months of 2018 and 2017. Expense of $378 and $247 was recorded during the nine months ended September 30, 2018 and 2017, respectively.

NOTE 8 - EMPLOYEE BENEFITS

KSOP

The Company maintains an Employee Stock Ownership Plan containing Section 401(k) provisions covering substantially all employees (“KSOP”). The plan provides for a matching contribution of up to 5% of a participant’s qualified compensation starting January 1, 2016. At December 31, 2016, the plan included a repurchase obligation, or “put option”, which is a right to demand that the sponsor repurchase shares of employer stock distributed to the participant under the terms of the plan, for which there was no public market for such shares, at an established cash price. This put option was terminated upon completion of Guaranty’s initial public offering and listing of its common stock on the NASDAQ Global Select Market in May 2017. Guaranty’s total contributions accrued or paid during the nine months ended September 30, 2018 and 2017 totaled $856 and $739, respectively.

Upon separation from service or other distributable event, a participant's account under the KSOP may be distributed in kind in the form of the GNTY common shares allocated to his or her account (with the balance payable in cash), or the entire account can be liquidated and distributed in cash.

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As of December 31, 2016, the fair value of common stock, held by the KSOP, was deducted from permanent shareholders' equity in the consolidated statement of changes in shareholders equity, and reflected in a column between accumulated other comprehensive income and total shareholders' equity. This presentation was necessary in order to recognize the put option within the KSOP-owned shares, consistent with SEC guidelines, because the Company was not yet publicly traded. The Company used a valuation by an external third party to determine the maximum possible cash obligation related to those securities. Increases or decreases in the value of the cash obligation were included in a separate line item in the consolidated statements of changes in shareholders' equity. As described above, the put option was terminated upon completion of our initial public offering and the prior value of $34,300 is shown as "Terminated KSOP put option" in the consolidated statement of changes in shareholders' equity for the nine months ended September 30, 2017.

As of September 30, 2018 and December 31, 2017, the number of shares held by the KSOP were 1,320,876 and 1,314,277, respectively. There were no unallocated shares to plan participants as of September 30, 2018 or as of December 31, 2017. During the nine months ended September 30, 2017, the Company did not repurchase any shares from KSOP participants that received distributions of shares from the KSOP which were subject to the put option that applied to the KSOP shares before we were publicly traded. All shares held by the KSOP were treated as outstanding at each of the respective period ends.

Executive Incentive Retirement Plan

The Company established a non-qualified, non-contributory executive incentive retirement plan covering a selected group of key personnel to provide benefits equal to amounts computed under an "award criteria" at various targeted salary levels as adjusted for annual earnings performance of the Company. The plan is non-funded.

In connection with the Executive Incentive Retirement Plan, the Company has purchased life insurance policies on the respective officers. The cash surrender value of life insurance policies held by the Company totaled $25,747 and $19,117 as of September 30, 2018 and December 31, 2017, respectively.

Expense related to these plans totaled $419 and $381 for the nine months ended September 30, 2018 and 2017, respectively, and is included in employee compensation and benefits on the Company's consolidated statements of earnings. The recorded liability totaled approximately $3,678 and $2,420 as of September 30, 2018 and December 31, 2017, respectively and is included in accrued interest and other liabilities on the Company's consolidated balance sheets.

Bonus Plan

The Company has a bonus plan that rewards officers and employees based on performance of individual business units of the Company. Earnings and growth performance goals for each business unit and for the Company as a whole are established at the beginning of the calendar year and approved annually by Guaranty's board of directors. The Bonus Plan provides for a predetermined bonus amount to be contributed to the employee bonus pool based on (i) earnings target and growth for individual business units and (ii) achieving certain pre-tax return on average equity and pre-tax return on average asset levels for the Company as a whole. These bonus amounts are established annually by Guaranty's board of directors. The bonus expense under this plan for the nine months ended September 30, 2018 and 2017 totaled $2,170 and $1,718, respectively and is included in employee compensation and benefits on the consolidated statements of earnings.

NOTE 9 - INCOME TAXES

Tax Cuts and Jobs Act

The Tax Cuts and Jobs Act was enacted on December 22, 2017. Among other things, the new law (i) establishes a new, flat corporate federal statutory income tax rate of 21%, (ii) eliminates the corporate alternative minimum tax and allows the use of any such carryforwards to offset regular tax liability for any taxable year, (iii) limits the deduction for net interest expense incurred by U.S. corporations, (iv) allows businesses to immediately expense, for tax purposes, the cost of new investments in certain qualified depreciable assets, (v) eliminates or reduces certain deductions related to meals and entertainment expenses, (vi) modifies the limitation on excessive employee remuneration to eliminate the exception for performance-based compensation and clarifies the definition of a covered employee and (vii) limits

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the deductibility of deposit insurance premiums. The Tax Cuts and Jobs Act also significantly changes U.S. tax law related to foreign operations; however, such changes do not currently impact us.

As stated above, as a result of the enactment of the Tax Cuts and Jobs Act on December 22, 2017, we remeasured our deferred tax assets and liabilities based upon the newly enacted U.S. statutory federal income tax rate of 21%, which is the tax rate at which these assets and liabilities are expected to reverse in the future. Notwithstanding the foregoing, we are still analyzing certain aspects of the new law and refining our calculations, which could affect the measurement of these assets and liabilities or give rise to new deferred tax amounts.

Income tax expense was as follows for:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Income tax expense for the period	$1,160	$1,699	$3,126	$4,644
Effective tax rate	18.56 %	29.10 %	18.16 %	28.54 %

The effective tax rates differ from the statutory federal tax rate of 21% for the nine months ended September 30, 2018 and 35.0% for the nine months ended September 30, 2017, respectively, largely due to tax exempt interest income earned on certain investment securities and loans and the nontaxable earnings on bank owned life insurance.

NOTE 10 - DERIVATIVE FINANCIAL INSTRUMENTS

The Company utilizes certain derivative financial instruments. Stand-alone derivative financial instruments such as interest rate swaps, are used to economically hedge interest rate risk related to the Company’s liabilities. These derivative instruments involve both credit and market risk. The notional amounts are amounts on which calculations, payments, and the value of the derivative are based. Notional amounts do not represent direct credit exposures. Direct credit exposure is limited to the net difference between the calculated amounts to be received and paid, if any. Such difference, which represents the fair value of the derivative instruments, is reflected on the Company’s consolidated balance sheet in other liabilities.

The Company is exposed to credit related losses in the event of nonperformance by the counterparties to those agreements. The Company controls the credit risk of its financial contracts through credit approvals, limits and monitoring procedures, and does not expect any counterparties to fail to perform their respective obligations.

The Company entered into interest rate swaps to receive payments at a fixed rate in exchange for paying a floating rate on the debentures discussed in Note 6. Management believes that entering into the interest rate swaps exposed the Company to variability in their fair value due to changes in the level of interest rates. It is the Company’s objective to hedge the change in fair value of floating rate debentures at coverage levels that are appropriate, given anticipated or existing interest rate levels and other market considerations, as well as the relationship of change in this liability to other liabilities of the Company. To meet this objective, the Company utilizes interest rate swaps as an asset/liability management strategy to hedge the change in value of the cash flows due to changes in expected interest rate assumptions.

Interest rate swaps with notional amounts totaling $5,000 as of September 30, 2018 and December 31, 2017, were designated as cash flow hedges of the debentures and were determined to be fully effective during all periods presented. As such, no amount of ineffectiveness has been included in net income.

Therefore, the aggregate fair value of the swaps is recorded in accrued interest and other liabilities within the Company’s consolidated balance sheets with changes in fair value recorded in other comprehensive income. The amount included in accumulated other comprehensive income would be reclassified to current earnings should the hedges no longer be considered effective. The Company expects the hedges to remain fully effective during the remaining terms of the swaps.

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The information pertaining to outstanding interest rate swap agreements used to hedge floating rate debentures was as follows as of:

Notional Amount	Pay Rate	Receive Rate	Effective Date	Maturity in Years	Unrealized Losses
September 30, 2018:					
$2,000	5.979%	3 month LIBOR plus 1.67%	10/1/2016	7.50	$ 174
$3,000	7.505%	3 month LIBOR plus 3.35%	10/30/2012	4.08	$ 134

Notional Amount	Pay Rate	Receive Rate	Effective Date	Maturity in Years	Unrealized Losses
December 31, 2017:					
$2,000	5.979%	3 month LIBOR plus 1.67%	10/1/2016	8.25	$ 301
$3,000	7.505%	3 month LIBOR plus 3.35%	10/30/2012	4.83	$ 270

Interest expense recorded on these swap transactions totaled $516 and $559 during the nine months ended September 30, 2018 and 2017, respectively, and is reported as a component of interest expense on the debentures. At September 30, 2018, the Company expected none of the unrealized loss to be reclassified as a reduction of interest expense during the remainder of 2018.

NOTE 11 - COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Company enters into various transactions, which, in accordance with GAAP, are not included in its consolidated balance sheets. These transactions are referred to as “off-balance sheet commitments.” The Company enters into these transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and letters of credit, which involve elements of credit risk in excess of the amounts recognized in the consolidated balance sheets. The Company minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures.

The Company enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Customers use credit commitments to ensure that funds will be available for working capital purposes, for capital expenditures and to ensure access to funds at specified terms and conditions. Substantially all of the Company’s commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of the allowance for credit losses.

Letters of credit are written conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The Company’s policies generally require that letters of credit arrangements contain security and debt covenants similar to those contained in loan agreements. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount shown in the table below. If the commitment were funded, the Company would be entitled to seek recovery from the customer. As of September 30, 2018 and December 31, 2017, no amounts have been recorded as liabilities for the Bank’s potential obligations under these guarantees.

Commitments and letters of credit outstanding were as follows as of:

	Contract or Notional Amount	
	September 30, 2018	December 31, 2017
Commitments to extend credit	$347,297	$ 326,879
Letters of credit	10,369	8,336

(Continued)
34.

Litigation

The Company is involved in certain claims and lawsuits occurring in the normal course of business. Management, after consultation with legal counsel, does not believe that the outcome of these actions, if determined adversely, would have a material impact on the consolidated financial statements of the Company.

FHLB Letters of Credit

At September 30, 2018, the Company had letters of credit of $2,000 pledged to secure public deposits, repurchase agreements, and for other purposes required or permitted by law.

NOTE 12 - REGULATORY MATTERS

The Company on a consolidated basis and the Bank are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company’s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company’s assets, liabilities, and certain off balance sheet items as calculated under regulatory accounting practices. The Company’s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The Basel III Capital Rules, a comprehensive capital framework for U.S. banking organizations, became effective for the Company and Bank on January 1, 2015, with certain transition provisions to be fully phased in by January 1, 2019. Quantitative measures established by the Basel III Capital Rules to ensure capital adequacy require the maintenance of minimum amounts and ratios (set forth in the table below) of Common Equity Tier 1 capital, Tier 1 capital and Total capital (as defined in the regulations) to risk-weighted assets (as defined), and or Tier 1 capital to adjusted quarterly average assets (as defined). Management believes, as of September 30, 2018 and December 31, 2017 that the Bank met all capital adequacy requirements to which it was subject.

When fully phased in on January 1, 2019, the Basel III Capital Rules, among other things, will have (i) introduced a new capital measure called “Common Equity Tier I” (“CETI”), (ii) specified that Tier I capital consist of CETI and “Additional Tier I Capital” instruments meeting specified requirements, (iii) defined CETI narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CETI and not to the other components of capital and (iv) expanded the scope of the deductions/adjustments as compared to existing regulations.

Starting in January 2016, the implementation of the capital conservation buffer was effective for the Company starting at the 0.625% level and increasing 0.625% each year thereafter, until it reaches 2.5% on January 1, 2019. The capital conservation buffer is designed to absorb losses during periods of economic stress and effectively increases the minimum required risk-weighted capital ratios.

As of September 30, 2018 and December 31, 2017, the Company’s capital ratios exceeded those levels necessary to be categorized as “well capitalized” under the regulatory framework for prompt corrective action. To be categorized as “well capitalized”, the Company must maintain minimum total risk-based, CETI, Tier 1 risk-based and Tier I leverage ratios as set forth in the table. There are no conditions or events since September 30, 2018 that management believes have changed the Company’s category.

The Federal Reserve’s guidelines regarding the capital treatment of trust preferred securities limits restricted core capital elements (including trust preferred securities and qualifying perpetual preferred stock) to 25% of all core

capital elements, net of goodwill less any associated deferred tax liability. Because the Company's aggregate amount of trust preferred securities is less than the limit of 25% of Tier I capital, net of goodwill, the rules permit the inclusion of $10,310 of trust preferred securities in Tier I capital at September 30, 2018 and December 31, 2017. Additionally, the rules provide that trust preferred securities would no longer qualify for Tier I capital within five years of their maturity, but would be included as Tier 2 capital. However, the trust preferred securities would be amortized out of Tier 2 capital by

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one-fifth each year and excluded from Tier 2 capital completely during the year prior to maturity of the subordinated debentures.

A comparison of the Company’s and Bank’s actual capital amounts and ratios to required capital amounts and ratios are presented in the following tables as of:

	Actual		Minimum Required For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2018						
Total capital to risk-weighted assets:						
Consolidated	$240,775	13.23%	$145,631	8.00%		n/a
Bank	240,590	13.22%	145,610	8.00%	$182,013	10.00%
Tier 1 capital to risk-weighted assets:						
Consolidated	226,334	12.43%	109,223	6.00%		n/a
Bank	226,149	12.42%	109,208	6.00%	145,610	8.00 %
Tier 1 capital to average assets:						
Consolidated	226,334	10.29%	87,943	4.00%		n/a
Bank	226,149	10.29%	87,934	4.00%	109,918	5.00 %
Common equity tier 1 capital to risk-weighted assets:						
Consolidated	216,024	11.87%	81,917	4.50%		n/a
Bank	226,149	12.42%	81,906	4.50%	118,308	6.50 %

	Actual		Minimum Required For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2017						
Total capital to risk-weighted assets:						
Consolidated	$215,720	14.13%	$122,111	8.00%		n/a
Bank	206,490	13.53%	122,122	8.00%	$152,652	10.00%
Tier 1 capital to risk-weighted assets:						
Consolidated	202,861	13.29%	91,583	6.00%		n/a
Bank	193,631	12.68%	91,591	6.00%	122,122	8.00 %
Tier 1 capital to average assets:						
Consolidated	202,861	10.53%	77,048	4.00%		n/a
Bank	193,631	10.05%	77,054	4.00%	96,318	5.00 %
Common equity tier 1 capital to risk-weighted assets:						
Consolidated	192,551	12.61%	68,687	4.50%		n/a
Bank	193,631	12.68%	68,694	4.50%	99,224	6.50 %

Dividends paid by Guaranty are mainly provided by dividends from its subsidiaries. However, certain regulatory restrictions exist regarding the ability of its bank subsidiary to transfer funds to Guaranty in the form of cash dividends, loans or advances. The amount of dividends that a subsidiary bank organized as a national banking association, such as the Bank, may declare in a calendar year is the subsidiary bank's net profits for that year combined with its retained net profits for the preceding two years.

(Continued)

NOTE 13 - FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1 - Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 - Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 - Significant unobservable inputs that reflect a company’s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate fair value:

Marketable Securities: The fair values for marketable securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

Loans Held For Sale: Loans held for sale are carried at the lower of cost or fair value, which is evaluated on a pool-level basis. The fair value of loans held for sale is determined using quoted prices for similar assets, adjusted for specific attributes of that loan or other observable market data, such as outstanding commitments from third party investors (Level 2).

Derivative Instruments: The fair values of derivatives are based on valuation models using observable market data as of the measurement date (Level 2).

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on the present value of estimated future cash flows using the loan's existing rate or, if repayment is expected solely from the collateral, the fair value of collateral, less costs to sell. The fair value of real estate collateral is determined using recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant (Level 3). Non-real estate collateral may be valued using an appraisal, net book value per the borrower’s financial statements, or aging reports, adjusted or discounted based on management’s historical knowledge, changes in market conditions from the time of the valuation, and management’s expertise and knowledge of the client and client’s business (Level 3). Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Other Real Estate Owned: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of

cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals which are updated no less frequently than annually. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Real estate owned properties are evaluated on a quarterly basis for additional impairment and adjusted accordingly (Level 3).

(Continued)

The following tables summarize quantitative disclosures about the fair value measurements for each category of financial assets (liabilities) carried at fair value:

As of September 30, 2018	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets (liabilities) at fair value on a recurring basis:				
Available for sale securities:				
Mortgage-backed securities	$86,761	$ —	$ 86,761	$ —
Collateralized mortgage obligations	111,140	—	111,140	—
Municipal securities	15,363	—	15,363	—
Corporate bonds	19,114	—	19,114	—
Derivative instruments	(308)	—	(308)	—
Assets at fair value on a nonrecurring basis:				
Impaired loans	11,372	—	—	11,372
Other real estate owned	1,783	—	—	1,783

As of December 31, 2017	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets (liabilities) at fair value on a recurring basis:				
Available for sale securities:				
Mortgage-backed securities	$90,678	$ —	$ 90,678	$ —
Collateralized mortgage obligations	115,311	—	115,311	—
Municipal securities	7,546	—	7,546	—
Corporate bonds	18,837	—	18,837	—
Derivative instruments	(571)	—	(571)	—
Assets at fair value on a nonrecurring basis:				
Impaired loans	6,206	—	—	6,206
Other real estate owned	2,244	—	—	2,244

There were no transfers between Level 2 and Level 3 during the nine months ended September 30, 2018 or for the year ended December 31, 2017.

Nonfinancial Assets and Nonfinancial Liabilities

Nonfinancial assets measured at fair value on a nonrecurring basis during the nine months ended September 30, 2018 and 2017 include certain foreclosed assets which, upon initial recognition, were remeasured and reported at fair value through a charge-off to the allowance for loan losses and certain foreclosed assets which, subsequent to their initial recognition, were remeasured at fair value through a write-down included in current earnings. The fair value of a foreclosed asset is estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria.

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(Dollars in thousands, except per share data)

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

	September 30, 2018	December 31, 2017	September 30, 2017
Other real estate owned remeasured at initial recognition:			
Carrying value of other real estate owned prior to remeasurement	$ 180	$ 1,082	$ 544
Charge-offs recognized in the allowance for loan losses	(23)	(195)	(175)
Fair value of other real estate owned remeasured at initial recognition	$ 157	$ 887	$ 369
Other real estate owned remeasured subsequent to initial recognition:			
Carrying value of other real estate owned prior to remeasurement	$ 599	$ —	$ —
Write-downs included in collection and other real estate owned expense	(56)	—	—
Fair value of other real estate owned remeasured subsequent to initial recognition	$ 543	$ —	$ —

The following tables present quantitative information about nonrecurring Level 3 fair value measurements as of:

	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
September 30, 2018				
Impaired loans	$ 11,372	Fair value of collateral - sales comparison approach	Selling costs or other normal adjustments: Real estate Equipment	10%-20% (16%) 10%-20% (19.9%)
Other real estate owned	$ 1,783	Appraisal value of collateral	Selling costs or other normal adjustments	10%-20% (16%)

	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
December 31, 2017				
Impaired loans	$ 6,206	Fair value of collateral - sales comparison approach	Selling costs or other normal adjustments: Real estate Equipment	10%-20% (16%) 10%-20% (3.6%)
Other real estate owned	$ 2,244	Appraisal value of collateral	Selling costs or other normal adjustments	10%-20% (16%)

GUARANTY BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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The carrying amounts and estimated fair values of financial instruments not previously discussed in this note, as of September 30, 2018 and December 31, 2017, are as follows:

	Fair value measurements as of September 30, 2018 using:				
	Carrying Amount	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Financial assets:					
Cash, due from banks, federal funds sold and interest-bearing deposits	$54,051	$54,051	$—	$ —	$54,051
Marketable securities held to maturity	164,839	—	162,596	—	162,596
Loans, net	1,638,149	—	—	1,622,802	1,622,802
Accrued interest receivable	7,760	—	7,760	—	7,760
Nonmarketable equity securities	13,818	—	13,818	—	13,818
Cash surrender value of life insurance	25,747	—	25,747	—	25,747
Financial liabilities:					
Deposits	$1,837,339	$1,443,080	$393,086	$ —	$1,836,166
Securities sold under repurchase agreements	11,107	—	11,107	—	11,107
Accrued interest payable	1,464	—	1,464	—	1,464
Federal Home Loan Bank advances	129,140	—	128,853	—	128,853
Subordinated debentures	12,810	—	10,662	—	10,662

	Fair value measurements as of December 31, 2017 using:				
	Carrying Amount	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Financial assets:					
Cash, due from banks, federal funds sold and interest-bearing deposits	$91,428	$91,428	$—	$ —	$91,428
Marketable securities held to maturity	174,684	—	176,790	—	176,790
Loans, net	1,347,779	—	—	1,346,361	1,346,361
Accrued interest receivable	8,174	—	8,174	—	8,174
Nonmarketable equity securities	9,453	—	9,453	—	9,453
Cash surrender value of life insurance	19,117	—	19,117	—	19,117
Financial liabilities:					
Deposits	$1,676,320	$1,378,467	$297,978	$ —	$1,676,445
Securities sold under repurchase agreements	12,879	—	12,879	—	12,879
Accrued interest payable	922	—	922	—	922
Federal Home Loan Bank advances	45,153	—	44,722	—	44,722
Subordinated debentures	13,810	—	11,495	—	11,495

The methods and assumptions, not previously presented, used to estimate fair values are described as follows:

Cash and Cash Equivalents
The carrying amounts of cash and short-term instruments approximate fair values (Level 1).

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Loans, net
The fair value of fixed-rate loans and variable-rate loans that reprice on an infrequent basis is estimated by discounting future cash flows using the current interest rates at which similar loans with similar terms would be made to borrowers of similar credit quality (Level 3).

Cash Surrender Value of Life Insurance
The carrying amounts of bank-owned life insurance approximate their fair value.

Nonmarketable Equity Securities
It is not practical to determine the fair value of Independent Bankers Financial Corporation, Federal Home Loan Bank, Federal Reserve Bank and other stock due to restrictions placed on its transferability.

Deposits and Securities Sold Under Repurchase Agreements
The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) (Level 1). The fair values of deposit liabilities with defined maturities are estimated by discounting future cash flows using interest rates currently offered for deposits of similar remaining maturities (Level 2).

Other Borrowings
The fair value of borrowings, consisting of lines of credit, Federal Home Loan Bank advances and Subordinated debentures is estimated by discounting future cash flows using currently available rates for similar financing (Level 2).

Accrued Interest Receivable/Payable
The carrying amounts of accrued interest approximate their fair values (Level 2).

Off-balance Sheet Instruments
Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of commitments is not material.

NOTE 14 - EARNINGS PER SHARE

Basic earnings per share is computed by dividing net earnings available to common shareholders by the weighted-average common shares outstanding for the period. Diluted earnings per share reflects the maximum potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock and would then share in the net earnings of the Company. Dilutive share equivalents include stock-based awards issued to employees.

Stock options granted by the Company are treated as potential shares in computing earnings per share. Diluted shares outstanding include the dilutive effect of in-the-money awards which is calculated based on the average share price for each fiscal period using the treasury stock method. Under the treasury stock method, the amount that the employee must pay for exercising stock options, the amount of compensation cost for future service that the Company has not yet recognized, and the amount of tax impact that would be recorded in additional paid-in capital when the award

becomes deductible are assumed to be used to repurchase shares.

(Continued)

GUARANTY BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)

The computations of basic and diluted earnings per share for the Company were as follows for the:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Numerator:				
Net earnings (basic)	$5,091	$ 4,139	$14,084	$ 11,631
Net earnings (diluted)	$5,091	$ 4,139	$14,084	$ 11,631
Denominator:				
Weighted-average shares outstanding (basic)	11,962,651	11,058,956	11,452,968	9,951,767
Effect of dilutive securities:				
Common stock equivalent shares from stock options	70,780	105,473	100,539	75,505
Weighted-average shares outstanding (diluted)	12,033,431	11,164,429	11,553,507	10,027,272
Net earnings per share				
Basic	$0.43	$ 0.37	$1.23	$ 1.17
Diluted	$0.42	$ 0.37	$1.22	$ 1.16

(Continued)

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and notes thereto appearing in Item 1 of Part I of this Quarterly Report on Form 10-Q (this "Report") and any subsequent Quarterly Reports on Form 10-Q, other risks and uncertainties listed from time to time in our reports and documents filed with the SEC, including our Annual Report on Form 10-K for the year ended December 31, 2017. Unless the context indicates otherwise, references in this Report to "we," "our," "us," and the "Company" refer to Guaranty Bancshares, Inc., a Texas corporation, and its consolidated subsidiaries. References in this Report to "Guaranty Bank & Trust" and the "Bank" refer to Guaranty Bank & Trust, N.A., a national banking association and our wholly-owned consolidated subsidiary.

General

We were incorporated in 1990 to serve as the holding company for Guaranty Bank & Trust. Since our founding, we have built a reputation based on financial stability and community leadership. In May 2017, we consummated an initial public offering of our common stock, which is traded on the NASDAQ Global Select Market under the symbol "GNTY."

We currently operate 32 banking locations in the East Texas, Dallas/Fort Worth, Central Texas and Greater Houston regions of the state. Our principal executive office is located at 201 South Jefferson Street, Mount Pleasant, Texas 75455, and our telephone number is (888) 572-9881. Our website address is www.gnty.com. Information contained on our website does not constitute a part of this Report and is not incorporated by reference into this filing or any other report.

As a bank holding company that operates through one segment, we generate most of our revenue from interest on loans and investments, customer service and loan fees, fees related to the sale of mortgage loans, and trust and wealth management services. We incur interest expense on deposits and other borrowed funds, as well as noninterest expense, such as salaries and employee benefits and occupancy expenses. We analyze our ability to maximize income generated from interest earning assets and control the interest expenses of our liabilities, measured as net interest income, through our net interest margin and net interest spread. Net interest income is the difference between interest income on interest-earning assets, such as loans and securities, and interest expense on interest-bearing liabilities, such as deposits and borrowings, which are used to fund those assets. Net interest margin is a ratio calculated as net interest income divided by average interest-earning assets. Net interest spread is the difference between rates earned on interest-earning assets and rates paid on interest-bearing liabilities.

Changes in market interest rates and the interest rates we earn on interest-earning assets or pay on interest-bearing liabilities, as well as in the volume and types of interest-earning assets, interest-bearing and noninterest-bearing liabilities and shareholders' equity, are usually the largest drivers of periodic changes in net interest spread, net interest margin and net interest income. Fluctuations in market interest rates are driven by many factors, including governmental monetary policies, inflation, deflation, macroeconomic developments, changes in unemployment, the money supply, political and international conditions and conditions in domestic and foreign financial markets. Periodic changes in the volume and types of loans in our loan portfolio are affected by, among other factors, economic and competitive conditions in Texas, as well as developments affecting the real estate, technology, financial services, insurance, transportation, manufacturing and energy sectors within our target markets and throughout the State of Texas.

Certain Events Affect Year-over-Year Comparability

Acquisition of Westbound Bank. The Company completed the acquisition of Westbound Bank (Westbound), a Texas banking association, on June 1, 2018. This acquisition increased total assets by $216.1 million, loans, net of discount, by $154.7 million and deposits by $181.4 million. The comparability of the Company's consolidated financial condition as of December 31, 2017 and September 30, 2018 and results of operations for the three and nine months ended September 30, 2018 and September 30, 2017 are affected by this acquisition.

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Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with GAAP and with general practices within the financial services industry. Application of these principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under current circumstances. These assumptions form the basis for our judgments about the carrying values of assets and liabilities that are not readily available from independent, objective sources. We evaluate our estimates on an ongoing basis. Use of alternative assumptions may have resulted in significantly different estimates. Actual results may differ from these estimates.

We have identified the following accounting policies and estimates that, due to the difficult, subjective or complex judgments and assumptions inherent in those policies and estimates, and the potential sensitivity of our consolidated financial statements to those judgments and assumptions, is critical to an understanding of our financial condition and results of operations. We believe that the judgments, estimates and assumptions used in the preparation of our financial statements are appropriate.

Loans and Allowance for Loan Losses

Loans are stated at the amount of unpaid principal, reduced by unearned income and an allowance for loan losses. Interest on loans is recognized using the simple-interest method on the daily balances of the principal amounts outstanding. Fees associated with the origination of loans and certain direct loan origination costs are netted and the net amount is deferred and recognized over the life of the loan as an adjustment of yield.

The accrual of interest on loans is discontinued when there is a clear indication that the borrower’s cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. A loan may continue to accrue interest, even if it is more than 90 days past due, if the loan is both well collateralized and it is in the process of collection. When a loan is placed on nonaccrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining book balance of the asset is deemed to be collectible. If collectability is questionable, then cash payments are applied to principal. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured in accordance with the terms of the loan agreement.

The allowance for loan losses is an estimated amount management believes is adequate to absorb inherent losses on existing loans that may be uncollectible based upon review and evaluation of our loan portfolio. Management’s periodic evaluation of the allowance is based on general economic conditions, the financial condition of borrowers, the value and liquidity of collateral, delinquency, prior loan loss experience and the results of periodic reviews of the portfolio.

The allowance for loan losses is comprised of two components. The first component, the general reserve, is determined in accordance with current authoritative accounting guidance that considers historical loss rates for the last five years adjusted for qualitative factors based upon general economic conditions and other qualitative risk factors both internal and external to us. Such qualitative factors include current local economic conditions and trends including unemployment, changes in lending staff, policies and procedures, changes in credit concentrations, changes in the trends and severity of problem loans and changes in trends in volume and terms of loans. These qualitative factors serve to compensate for additional areas of uncertainty inherent in the portfolio that are not reflected in our historic loss factors. For purposes of determining the general reserve, the loan portfolio, less cash secured loans, government guaranteed loans and impaired loans, is multiplied by our adjusted historical loss rate. The second component of the allowance for loan losses, the specific reserve, is determined in accordance with current authoritative accounting guidance based on probable and incurred losses on specific classified loans.

The allowance for loan losses is increased by charges to income and decreased by charge-offs (net of recoveries).

In general, the loans in our portfolio have low historical credit losses. The credit quality of loans in our portfolio is impacted by delinquency status and debt service coverage generated by our borrowers’ businesses and fluctuations in the value of real estate collateral. Management considers delinquency status to be the most meaningful indicator of the credit quality of one-to-four single family residential, home equity loans and lines of credit and other consumer loans. In general, loans do not begin to show signs of credit deterioration or default until they have been outstanding

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for some period of time, a process we refers to as “seasoning.” As a result, a portfolio of older loans will usually behave more predictably than a portfolio of newer loans. We consider the majority of our loans to be “seasoned” and that the credit quality and current level of delinquencies and defaults represents the level of reserve needed in the allowance for loan losses. If delinquencies and defaults were to increase, we may be required to increase our provision for loan losses, which would adversely affect our results of operations and financial condition.

Delinquency statistics are updated at least monthly. Internal risk ratings are considered the most meaningful indicator of credit quality for new commercial and industrial, construction, and commercial real estate loans. Internal risk ratings are a key factor in identifying loans that are individually evaluated for impairment and impact management’s estimates of loss factors used in determining the amount of the allowance for loan losses. Internal risk ratings are updated on a continuous basis.

Loans are considered impaired when, based on current information and events, it is probable we will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. If a loan is impaired, a specific valuation allowance is allocated, if necessary. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Our policy requires measurement of the allowance for an impaired collateral dependent loan based on the fair value of the collateral. Other loan impairments are measured based on the present value of expected future cash flows or the loan’s observable market price. As of September 30, 2018 and December 31, 2017, all significant impaired loans have been determined to be collateral dependent and the allowance for loss has been measured utilizing the estimated fair value of the collateral.

From time to time, we modify our loan agreement with a borrower. A modified loan is considered a troubled debt restructuring when two conditions are met: (i) the borrower is experiencing financial difficulty and (ii) concessions are made by us that would not otherwise be considered for a borrower with similar credit risk characteristics. Modifications to loan terms may include a lower interest rate, a reduction of principal, or a longer term to maturity. We review each troubled debt restructured loan and determine on a case by case basis if the loan is subject to impairment and the need for a specific allowance for loan loss allocation. An allowance for loan loss allocation is based on either the present value of estimated future cash flows or the estimated fair value of the underlying collateral.

We have certain lending policies and procedures in place that are designed to maximize loan income with an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis and makes changes as appropriate. Management receives frequent reports related to loan originations, quality, concentrations, delinquencies, non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions, both by type of loan and geography.

Commercial and industrial loans are underwritten after evaluating and understanding the borrower’s ability to operate profitably and effectively. Underwriting standards are designed to determine whether the borrower possesses sound business ethics and practices and to evaluate current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and, secondarily, on the underlying collateral provided by the borrower. Most commercial and industrial loans are secured by the assets being financed or other business assets, such as accounts receivable or inventory, and include personal guarantees.

Real estate loans are also subject to underwriting standards and processes similar to commercial and industrial loans. These loans are underwritten primarily based on projected cash flows and, secondarily, as loans secured by real estate collateral. The repayment of real estate loans is generally largely dependent on the successful operation of the property securing the loans or the business conducted on the property securing the loan. Real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing our real estate portfolio are generally diverse in terms of type and geographic location throughout the State of Texas. This diversity helps us reduce the exposure to adverse economic events that affect any single market or industry.

We utilize methodical credit standards and analysis to supplement our policies and procedures in underwriting consumer loans. Our loan policy addresses types of consumer loans that may be originated as well as the underlying

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collateral, if secured, which must be perfected. The relatively small individual dollar amounts of consumer loans that are spread over numerous individual borrowers also minimizes risk.

Marketable Securities

Securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income. Management determines the appropriate classification of securities at the time of purchase. Interest income includes amortization and accretion of purchase premiums and discounts. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

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

Fair Values of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates. The fair value estimates of existing on and off-balance sheet financial instruments do not include the value of anticipated future business or the value of assets and liabilities not considered financial instruments.

Emerging Growth Company

The JOBS Act permits an “emerging growth company” to take advantage of an extended transition period to comply with new or revised accounting standards applicable to public companies. However, we have “opted out” of this provision. As a result, we will comply with new or revised accounting standards to the same extent that compliance is required for non-emerging growth companies. Our decision to opt out of the extended transition period under the JOBS Act is irrevocable.

Discussion and Analysis of Results of Operations for the Nine Months Ended September 30, 2018 and 2017

Results of Operations

The following discussion and analysis of our results of operations compares our results of operations for the nine months ended September 30, 2018 with the nine months ended September 30, 2017. The results of operations for the nine months ended September 30, 2018 are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2018.

Net earnings were $14.1 million for the nine months ended September 30, 2018, as compared to $11.6 million for the nine months ended September 30, 2017. The following table presents key earnings data for the periods indicated:

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	For the Nine Months Ended September 30,			
	2018		2017	
	(Dollars in thousands, except per share data)			
Net earnings	$14,084		$11,631	
Net earnings per common share				
-basic	1.23		1.17	
-diluted	1.22		1.16	
Net interest margin(1)	3.46	%	3.37	%
Net interest rate spread(2)	3.12	%	3.15	%
Return on average assets	0.90	%	0.82	%
Return on average equity	8.43	%	8.74	%
Average equity to average total assets	10.69	%	9.42	%
Dividend payout ratio	34.96	%	33.33	%

(1) Net interest margin is equal to net interest income divided by average interest-earning assets.
(2) Net interest rate spread is the average yield on interest-earning assets minus the average rate on interest-bearing liabilities.

Net Interest Income

Our operating results depend primarily on our net interest income. Fluctuations in market interest rates impact the yield and rates paid on interest-earning assets and interest-bearing liabilities, respectively. Changes in the amount and type of interest-earning assets and interest-bearing liabilities also impact our net interest income. To evaluate net interest income, we measure and monitor (1) yields on our loans and other interest-earning assets, (2) the costs of our deposits and other funding sources, (3) our net interest spread and (4) our net interest margin. Because noninterest-bearing sources of funds, such as noninterest-bearing deposits and shareholders' equity also fund interest-earning assets, net interest margin includes the benefit of these noninterest-bearing sources.

Net interest income, before the provision for loan losses, was $50.1 million compared to $44.1 million for the nine months ended September 30, 2018 and September 30, 2017, respectively, an increase of $5.9 million, or 13.4%. The increase in net interest income was comprised of a $10.6 million, or 20.1%, increase in interest income offset by a $4.7 million, or 52.8%, increase in interest expense. The growth in interest income was primarily attributable to a $214.6 million, or 16.9%, increase in average loans outstanding for the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017, further improved by a 0.24% increase in the average yield on total loans. The increase in average loans outstanding was primarily due to organic growth in all of our markets, continuing maturity of de novo and acquired locations in the Dallas/Fort Worth metroplex and Central Texas markets and the acquisition of Westbound on June 1, 2018. The $4.7 million increase in interest expense for the nine months ended September 30, 2018 was primarily related to a $62.7 million, or 5.0%, increase in average interest-bearing deposits and a $46.5 million, or 111.7%, increase in Federal Home Loan Bank advances over the same period in 2017. The majority of the average deposit balance increase was due to organic growth, primarily in time deposit and money market accounts, driven in part by favorable rates that were offered in our Central Texas, Houston and Dallas/Fort Worth metroplex markets and the acquisition of Westbound. For the nine months ended September 30, 2018, net interest margin and net interest spread were 3.46% and 3.12%, respectively, compared to 3.37% and 3.15% for the same period in 2017, which reflects the increases in interest income discussed above relative to the increases in interest expense.

Average Balance Sheet Amounts, Interest Earned and Yield Analysis

The following table presents an analysis of net interest income and net interest spread for the periods indicated, including average outstanding balances for each major category of interest-earning assets and interest-bearing liabilities, the interest earned or paid on such amounts, and the average rate earned or paid on such assets or liabilities, respectively. The table also sets forth the net interest margin on average total interest-earning assets for the same

periods. Interest earned on loans that are classified as nonaccrual is not recognized in income; however, the balances are reflected in average outstanding balances for the period. For the nine months ended September 30, 2018 and 2017, the amount of interest income not recognized on nonaccrual loans was not material. Any nonaccrual loans have been included in the table as loans carrying a zero yield.

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	For the Nine Months Ended September 30,					
	2018			2017		
	Average Outstanding Balance	Interest Earned/ Interest Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Interest Paid	Average Yield/ Rate
	(Dollars in thousands)					
Assets						
Interest-earnings assets:						
Total loans[1]	$1,483,961	$55,377	4.99 %	$1,269,387	$45,115	4.75 %
Securities available for sale	237,619	4,400	2.48 %	216,908	3,678	2.27 %
Securities held to maturity	169,211	3,125	2.47 %	184,269	3,340	2.42 %
Nonmarketable equity securities	8,826	300	4.54 %	7,012	379	7.23 %
Interest-bearing deposits in other banks	35,437	537	2.03 %	72,948	581	1.06 %
Total interest-earning assets	1,935,054	$63,739	4.40 %	1,750,524	$53,093	4.06 %
Allowance for loan losses	(13,589)			(12,040)		
Noninterest-earnings assets	161,855			144,937		
Total assets	$2,083,320			$1,883,421		
Liabilities and Stockholders' Equity						
Interest-bearing liabilities:						
Interest-bearing deposits	$1,306,244	$11,948	1.22 %	$1,243,536	$7,761	0.83 %
Advances from FHLB and fed funds purchased	88,200	1,181	1.79 %	41,661	294	0.94 %
Other debt	—	—	— %	8,973	300	4.48 %
Subordinated debentures	13,477	516	5.12 %	16,607	559	4.50 %
Securities sold under agreements to repurchase	12,749	34	0.36 %	12,937	37	0.38 %
Total interest-bearing liabilities	1,420,670	$13,679	1.29 %	1,323,714	$8,951	0.90 %
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	432,871			375,655		
Accrued interest and other liabilities	7,120			6,650		
Total noninterest-bearing liabilities	439,991			382,305		
Shareholders' equity	222,659			177,402		
Total liabilities and shareholders' equity	$2,083,320			$1,883,421		
Net interest rate spread[2]			3.12 %			3.15 %
Net interest income		$50,060			$44,142	
Net interest margin[3]			3.46 %			3.37 %

(1) Includes average outstanding balances of loans held for sale of $1.8 million and $1.7 million for the nine months ended September 30, 2018 and 2017, respectively.
(2) Net interest rate spread is the average yield on interest-earning assets minus the average rate on interest-bearing liabilities.
(3) Net interest margin is equal to net interest income divided by average interest-earning assets.

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

	For the Nine Months Ended September 30, 2018 vs. 2017 Increase (Decrease)		
	Due to Change in		Total Increase
	Volume	Rate	(Decrease)
	(Dollars in thousands)		
Interest-earning assets:			
Total loans	$10,706	$(444)	$10,262
Securities available for sale	513	209	722
Securities held to maturity	(372)	157	(215)
Nonmarketable equity securities	82	(161)	(79)
Interest-earning deposits in other banks	(760)	716	(44)
Total increase (decrease) in interest income	$10,169	$477	$10,646
Interest-bearing liabilities:			
Interest-bearing deposits	$767	$3,420	$4,187
Advances from FHLB and fed funds purchased	833	54	887
Other debt	—	(300)	(300)
Subordinated debentures	(160)	117	(43)
Securities sold under agreements to repurchase	(1)	(2)	(3)
Total increase in interest expense	1,439	3,289	4,728
Increase (decrease) in net interest income	$8,730	$(2,812)	$5,918

Provision for Loan Losses

The provision for loan losses is a charge to income in order to bring our allowance for loan losses to a level deemed appropriate by management based on factors such as historical loss experience, trends in classified and past due loans, volume and growth in the loan portfolio, current economic conditions in our markets and value of the underlying collateral. Loans are charged off against the allowance for loan losses when determined appropriate. Although management believes it uses the best information available to make determinations with respect to the provision for loan losses, future adjustments may be necessary if economic conditions differ from the assumptions used in making the determination.

The provision for loan losses for the nine months ended September 30, 2018 was $1.8 million compared to $2.3 million for the nine months ended September 30, 2017. The decrease in the provision expense resulted from a lower level of charge-offs during the period and relatively stable risk ratings and qualitative factors that contributed to the calculated reserve needed during the period. Net charge offs were $168,000 for the nine months ended September 30, 2018 compared to $1.2 million for the same period in 2017.

Noninterest Income

Our primary sources of recurring noninterest income are service charges on deposit accounts, merchant and debit card fees, fiduciary income, gains on the sale of loans, and income from bank-owned life insurance. Noninterest income does not include loan origination fees to the extent they exceed the direct loan origination costs, which are generally recognized over the life of the related loan as an adjustment to yield using the interest method.

The following table presents components of noninterest income for the nine months ended September 30, 2018 and 2017 and the period-over-period variations in the categories of noninterest income:

	For the Nine Months Ended September 30,		Increase (Decrease)
	2018	2017	
	(Dollars in thousands)		
Noninterest income:			
Service charges on deposit accounts	$2,661	$2,801	$ (140)
Merchant and debit card fees	2,637	2,301	336
Fiduciary income	1,179	1,055	124
Gain on sales of loans	1,871	1,490	381
Bank-owned life insurance income	418	347	71
Gain (loss) on sales of investment securities	(50)	25	(75)
Loan processing fee income	458	454	4
Other noninterest income	1,956	2,027	(71)
Total noninterest income	$11,130	$10,500	$ 630

Total noninterest income increased $630,000, or 6.0%, for the nine months ended September 30, 2018 compared to the same period in 2017. Material changes in the components of noninterest income are discussed below.

Service Charges on Deposit Accounts. We earn fees from our customers for deposit related services, and these fees constitute a significant and generally predictable component of our non-interest income. Service fee income was $2.7 million for the nine months ended September 30, 2018 compared to $2.8 million for the same period in 2017, a decrease of $140,000, or 5.0%. The decrease, despite an increase in deposit accounts, was primarily due to lower insufficient fund income in the current year, which resulted from increased usage of online banking and debit cards by customers, which limits the ability for deposit accounts to go into an overdrawn status.

Merchant and Debit Card Fees. We earn interchange income related to the activity of our customers' merchant debit card usage. Debit card interchange income was $2.6 million for the nine months ended September 30, 2018, compared to $2.3 million for the same period in 2017, an increase of $336,000, or 14.6%. The increase was primarily due to growth in the number of demand deposit accounts and debit card usage volume during 2018.

Fiduciary Income. We have trust powers and provide fiduciary and custodial services through our trust and wealth management division. Fiduciary income was $1.2 million for the nine months ended September 30, 2018, compared to $1.1 million for the nine months ended September 30, 2017, an increase of $124,000, or 11.8%. Revenue for our services fluctuates by month with the market value for all publicly-traded assets held in our investment management and fiduciary accounts, while a flat percentage is charged for custody-only accounts based on the book value. The fair value of managed assets held as of September 30, 2018 was $297.8 million, of which $149.0 million or 50.0%, were in custody-only services. The fair value of managed assets held as of September 30, 2017 was $304.7 million, of which $173.9 million, or 57.1%, were in custody-only services. Revenue increased despite fewer managed assets due to a shift from custody-only to managed and fiduciary accounts, both of which generate a higher fee than do custody-only accounts. Additionally, a fee increase was implemented during the fourth of quarter of 2017 which impacts the income produced in 2018, compared to the prior year.

Gain on Sales of Loans. We originate long-term fixed-rate mortgage loans for resale into the secondary market. We sold 281 loans for $59.2 million for the nine months ended September 30, 2018 compared to 270 loans for $49.4 million for the nine months ended September 30, 2017. Gain on sale of loans was $1.9 million for the nine months ended September 30, 2018, an increase of $381,000, or 25.6%, compared to $1.5 million for the same period in 2017, which reflects an increase in mortgage volume and the number of loans sold.

Bank-owned Life Insurance Income. We invest in bank-owned life insurance due to its attractive nontaxable return and protection against the loss of our key employees. We record income based on the growth of the cash surrender value of these policies as well as the annual yield net of fees and charges, including mortality charges. Income from bank-owned life insurance increased by $71,000, or 20.5%, for the nine months ended September 30, 2018 compared to the same period in 2017, primarily due to the purchase of $625,000 and $225,000 of additional bank owned life

insurance in the fourth quarter of 2017 and the first quarter of 2018, respectively.

Other. This category includes a variety of other income producing activities, including mortgage loan origination fees, wire transfer fees, loan administration fees, and other fee income. Other noninterest income decreased $71,000, or 3.5%, for the nine months ended September 30, 2018, compared to the same period in 2017 due primarily to a write down in the value of repossessed assets of $335,000, and a decline in the fair value of our SBA servicing asset by $164,000, primarily resulting from the payoff of several large loans. Other categories of noninterest income increased with the continued growth of the bank.

Noninterest Expense

Generally, noninterest expense is composed of all employee expenses and costs associated with operating our facilities, obtaining and retaining customer relationships and providing bank services. The largest component of noninterest expense is salaries and employee benefits. Noninterest expense also includes operational expenses, such as occupancy expenses, depreciation and amortization of our facilities and our furniture, fixtures and office equipment, professional and regulatory fees, including FDIC assessments, data processing expenses, and advertising and promotion expenses.

For the nine months ended September 30, 2018, noninterest expense totaled $42.2 million, an increase of $6.1 million, or 16.9%, compared to $36.1 million for the nine months ended September 30, 2017. The following table presents, for the periods indicated, the major categories of noninterest expense:

	For the Nine Months Ended September 30,		Increase (Decrease)
	2018	2017	
	(Dollars in thousands)		
Employee compensation and benefits	$23,723	$20,156	$ 3,567
Non-staff expenses:			
Occupancy expenses	6,076	5,552	524
Amortization	881	781	100
Software and Technology	1,849	1,533	316
FDIC insurance assessment fees	479	527	(48)
Legal and professional fees	2,549	1,472	1,077
Advertising and promotions	994	879	115
Telecommunication expense	476	412	64
ATM and debit card expense	857	766	91
Director and committee fees	802	760	42
Other noninterest expense	3,544	3,279	265
Total noninterest expense	$42,230	$36,117	$ 6,113

Material changes in the components of noninterest expense are discussed below.

Employee Compensation and Benefits. Salaries and employee benefits are the largest component of noninterest expense and include payroll expense, the cost of incentive compensation, benefit plans, health insurance and payroll taxes. Salaries and employee benefits were $23.7 million for the nine months ended September 30, 2018, an increase of $3.6 million, or 17.7%, compared to $20.2 million for the same period in 2017. The increase resulted from the addition of 57 full time equivalent employees, from 397 as of September 30, 2017 to 454 as of September 30, 2018, of which 28 new employees were related to the Westbound acquisition, nine were from our de novo locations in Austin and Fort Worth, Texas that were opened in the fourth quarter of 2017, and other employees that were added to support operational growth and our SBA department.

Occupancy Expenses. Occupancy expenses were $6.1 million for the nine months ended September 30, 2018, compared to $5.6 million for the same period in 2017, an increase of $524,000, or 9.4%. This category includes building, leasehold, furniture, fixtures and equipment depreciation totaling $2.2 million for the nine months ended September 30, 2018. The increase was due primarily to increased lease expense from the new locations in Austin and Fort Worth, as well as additional building maintenance and utility costs.

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Amortization. Amortization expenses increased $100,000, or 12.8%, from $781,000 for the nine months ended September 30, 2017 to $881,000 for the nine months ended September 30, 2018. The increase is due to the amortization of deposit premiums associated with the Westbound acquisition on June 1, 2018.

Software and Technology. Software and technology expenses increased $316,000, or 20.6%, from $1.5 million for the nine months ended September 30, 2017 to $1.8 million for the nine months ended September 30, 2018. The increase is attributable primarily to incremental processing fees resulting from growth in volume of our loan and deposit accounts.

Legal and professional fees. Legal and professional fees, which include audit, loan review and regulatory assessments, were $2.5 million and $1.5 million for the nine months ended September 30, 2018 and 2017, respectively, an increase of $1.1 million, or 73.2%. The increase was due primarily to legal and accounting costs associated with the acquisition of Westbound. Merger related expenses for the nine months ended September 30, 2018 were $1.1 million, of which $878,000 were for legal and professional expenses.

Advertising and Promotions. Advertising and promotion related expenses were $994,000 and $879,000 for the nine months ended September 30, 2018 and 2017, respectively. The increase of $115,000, or 13.1%, was primarily due to increases in advertising expense in our growth markets, especially Dallas/Fort Worth, Central Texas and Houston.

ATM and debit card expenses. We pay processing fees related to the activity of our customers' ATM and debit card usage. ATM and debit card expenses were $857,000 and $766,000, for the nine months ending September 30, 2018 and 2017, respectively. The expenses increased $91,000, or 11.9%, as a result of increased ATM and debit card usage by our customers.

Other. This category includes operating and administrative expenses, such as stock option expense, expenses and losses related to repossession of assets, small hardware and software purchases, expense of the value of stock appreciation rights, losses incurred on problem assets, OREO related expenses, gains or losses on the sale of OREO, business development expenses (e.g., travel and entertainment, charitable contributions and club memberships), insurance and security expenses. Other noninterest expense increased to $3.5 million for the nine months ended September 30, 2018, compared to $3.3 million for the same period in 2017, an increase of $265,000, or 8.1%. The increase was primarily due to increases in loan and filing expenses of $100,000, travel and lodging of $98,000, check charges paid by the bank of $37,000 and losses incurred on the sale of assets of $37,000. Other increases resulted from escalations in computer supplies and meals and entertainment period-over-period, partially offset by decreases in expenses incurred on losses sustained, office supplies, club dues and subscriptions.

Income Tax Expense

The amount of income tax expense we incur is influenced by the amounts of our pre-tax income, tax-exempt income and other nondeductible expenses. Deferred tax assets and liabilities are reflected at current income tax rates in effect for the period in which the deferred tax assets and liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

For the nine months ended September 30, 2018 and 2017, income tax expense totaled $3.1 million and $4.6 million, respectively. Our effective tax rates for the nine months ended 2018 and 2017 were 18.16% and 28.54%, respectively. The decline in income tax expense and effective tax rates were due to passage of the Tax Cuts and Jobs Act on December 22, 2017 that changed the Company's income tax rate from 35% to 21%.

Discussion and Analysis of Results of Operations for the Three Months Ended September 30, 2018 and 2017

Results of Operations

The following discussion and analysis of our results of operations compares our results of operations for the three months ended September 30, 2018 with the three months ended September 30, 2017. The results of operations for the three months ended September 30, 2018 are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2018.

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Net earnings were $5.1 million for the three months ended September 30, 2018, as compared to $4.1 million for the three months ended September 30, 2017. Basic earnings per share were $0.43 for the three months ended September 30, 2018 compared to $0.37 during the same period in 2017. Our third quarter net earnings were impacted by approximately $365,000 in nonrecurring expenses related to the acquisition of Westbound. Excluding the nonrecurring expenses related to our acquisition of Westbound, basic earnings per share during the third quarter of 2018 would be $0.46.

The following table presents key earnings data for the periods indicated:

	For the Three Months Ended September 30,			
	2018		2017	
	(Dollars in thousands, except per share data)			
Net earnings	$5,091		$4,139	
Net earnings per common share				
-basic	0.43		0.37	
-diluted	0.42		0.37	
Net interest margin(1)	3.50	%	3.38	%
Net interest rate spread(2)	3.12	%	3.13	%
Return on average assets	0.91	%	0.87	%
Return on average equity	8.39	%	7.99	%
Average equity to average total assets	10.86	%	10.86	%
Dividend payout ratio	35.25	%	34.73	%

(1) Net interest margin is equal to net interest income divided by average interest-earning assets.
(2) Net interest rate spread is the average yield on interest-earning assets minus the average rate on interest-bearing liabilities.

Net Interest Income

Net interest income, before the provision for loan losses, was $18.2 million compared to $15.1 million for the three months ended September 30, 2018 and 2017, respectively, an increase of $3.1 million, or 20.7%. The increase in net interest income was comprised of a $5.5 million, or 30.3%, increase in interest income offset by a $2.4 million, or 77.8%, increase in interest expense. The growth in interest income was primarily attributable to a $317.9 million, or 24.4%, increase in average loans outstanding for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, and further improved by a 0.40% increase in the average yield on total loans. The increase in average loans outstanding was primarily due to organic growth in all of our markets, continuing maturity of de novo and acquired locations in the Dallas/Fort Worth metroplex and Central Texas markets and completion of the Westbound acquisition on June 1, 2018. The $2.4 million increase in interest expense for the three months ended September 30, 2018 was primarily related to a $150.1 million, or 12.3%, increase in average interest-bearing deposits over the same period in 2017, and an increase in the average rate of 0.47%. The majority of this increase was due to organic growth, primarily in certificates of deposit accounts, driven in part by favorable rates that were offered in our Central Texas, Houston and Dallas/Fort Worth metroplex markets and the acquisition of Westbound. For the three months ended September 30, 2018, net interest margin and net interest spread were 3.50% and 3.12%, respectively, compared to 3.38% and 3.13% for the same period in 2017, which reflects the increases in interest income discussed above relative to the increases in interest expense.

Average Balance Sheet Amounts, Interest Earned and Yield Analysis

The following table presents an analysis of net interest income and net interest spread for the periods indicated, including average outstanding balances for each major category of interest-earning assets and interest-bearing liabilities, the interest earned or paid on such amounts, and the average rate earned or paid on such assets or liabilities, respectively. The table also sets forth the net interest margin on average total interest-earning assets for the same periods. Interest earned on loans that are classified as nonaccrual is not recognized in income; however, the balances are reflected in average outstanding balances for the period. For the three months ended September 30, 2018 and 2017, the amount of interest income not recognized on nonaccrual loans was not material. Any nonaccrual loans have been included in the table as loans carrying a zero yield.

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	For the Three Months Ended September 30,					
	2018			2017		
	Average Outstanding Balance	Interest Earned/ Interest Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Interest Paid	Average Yield/ Rate
	(Dollars in thousands)					
Assets						
Interest-earnings assets:						
Total loans[1]	$1,618,199	$20,879	5.12 %	$1,300,307	$15,486	4.72 %
Securities available for sale	239,993	1,465	2.42 %	245,409	1,376	2.22 %
Securities held to maturity	166,080	1,026	2.45 %	180,737	1,088	2.39 %
Nonmarketable equity securities	10,351	115	4.41 %	6,541	59	3.58 %
Interest-bearing deposits in other banks	32,545	190	2.32 %	40,997	156	1.51 %
Total interest-earning assets	2,067,168	$23,675	4.54 %	1,773,991	$18,165	4.06 %
Allowance for loan losses	(14,096)			(12,492)		