

GUARANTY BANCSHARES INC /TX/

Form 10-K

March 15, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 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.)

16475 Dallas Parkway, Suite 600

Addison, Texas 75001

(Address of principal executive offices) (Zip code)

(888) 572 - 9881

(Registrant's telephone number, including area code)

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

Title of Each Class of Securities	Name of Each Exchange on Which Registered
-----------------------------------	---

Common Stock, par value \$1.00 per share	NASDAQ Global Select Market
--	-----------------------------

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes Nox

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes Nox

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. Yesx No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 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). Yesx No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (229.405 of this chapter) is not contained herein, and will not be contained to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 under the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No
The aggregate market value of the shares of common stock held by non-affiliates based on the closing price of the common stock on the NASDAQ Global Select Market on June 29, 2018, the last day of the Registrant's most recently completed second fiscal quarter, was approximately \$394.0 million.

At March 8, 2019, the Company had 11,807,402 outstanding shares of common stock, par value \$1.00 per share.

Documents Incorporated By Reference:

Portions of the registrant's Definitive Proxy Statement relating to the 2019 Annual Meeting of Shareholders are incorporated by reference into Part III of this Annual Report on Form 10-K to the extent stated herein. Such Definitive Proxy Statement will be filed with the Securities and Exchange Commission within 120 days after the end of the registrant's fiscal year ended December 31, 2018.

GUARANTY BANCSHARES, INC.
TABLE OF CONTENTS

PART I		Page
Item 1.	<u>Business</u>	<u>1</u>
Item 1A.	<u>Risk Factors</u>	<u>18</u>
Item 1B.	<u>Unresolved Staff Comments</u>	<u>40</u>
Item 2.	<u>Properties</u>	<u>40</u>
Item 3.	<u>Legal Proceedings</u>	<u>40</u>
Item 4.	<u>Mine Safety Disclosures</u>	<u>41</u>
PART II		
Item 5.	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>42</u>
Item 6.	<u>Selected Financial Data</u>	<u>44</u>
Item 7.	<u>Management's Discussion and Analysis of Financial Condition and Result of Operations</u>	<u>47</u>
Item 7A.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>78</u>
Item 8.	<u>Financial Statements and Supplementary Data</u>	<u>80</u>
Item 9.	<u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	<u>81</u>
Item 9A.	<u>Controls and Procedures</u>	<u>81</u>
Item 9B.	<u>Other Information</u>	<u>82</u>
PART III		
Item 10.	<u>Directors, Executives Officers and Corporate Governance</u>	<u>83</u>
Item 11.	<u>Executive Compensation</u>	<u>83</u>
Item 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>83</u>
Item 13.	<u>Certain Relationships and Related Transactions, And Director Independence</u>	<u>83</u>
Item 14.	<u>Principal Accountant Fees and Services</u>	<u>83</u>
PART IV		
Item 15.	<u>Exhibits and Financial Statement Schedules</u>	<u>84</u>
	<u>Index to Exhibits</u>	<u>84</u>
	<u>Signatures</u>	<u>86</u>
	<u>Consolidated Financial Statements</u>	<u>F-1</u>

PART I

ITEM 1. BUSINESS

Our Company

Except where the context otherwise requires or where otherwise indicated, references in this Annual Report on Form 10-K to “we,” “us,” “our,” “our company,” the “Company” or “Guaranty” refer to Guaranty Bancshares, Inc. and our wholly-owned banking subsidiary, Guaranty Bank & Trust, N.A. and the terms “Bank” and “Guaranty Bank & Trust” refers to Guaranty Bank & Trust, N.A..

We are a bank holding company, with corporate headquarters in Addison, Texas and operational headquarters in Mount Pleasant, Texas, and additional executive offices in Bryan, Texas. Through our wholly owned subsidiary, Guaranty Bank & Trust, a national banking association, we provide a wide range of relationship-driven commercial and consumer banking, as well as trust and wealth management, products and services that are tailored to meet the needs of small- and medium-sized businesses, professionals and individuals. The Bank currently operates 30 full service banking locations in East Texas, Central Texas, the Dallas/Fort Worth metropolitan statistical area (MSA) and the Houston MSA. As of December 31, 2018, we had total assets of \$2.27 billion, total net loans of \$1.65 billion, total deposits of \$1.87 billion and total shareholders’ equity of \$244.6 million.

We completed an initial public offering of our common stock in May 2017 as an emerging growth company under the JOBS Act. Our common stock is listed on the NASDAQ Global Select Market under the symbol “GNTY.”

Our History and Growth

Guaranty Bank & Trust was originally chartered as a Texas state banking association over a century ago in 1913, and converted its charter to a national banking association in 2012. Guaranty was incorporated in 1990 to serve as the holding company for Guaranty Bank & Trust. Since our founding, we have built a strong reputation based on financial stability and community leadership. Our growth has been consistent and primarily organic, both through growth in our established markets and the entry into new markets with de novo banking locations. In 2013, we expanded from our East Texas markets by opening a de novo banking location in Bryan/College Station, Texas. In 2017, we opened de novo banking locations in Fort Worth and Austin, Texas. We have achieved organic growth by enhancing our lending and deposit relationships with existing customers and attracting new customers, as well as cross-selling our deposit, mortgage, trust and wealth management and treasury management products. Our expansion strategy has enabled us to access markets with stronger loan demand, achieve consistent growth, maintain stable operating efficiencies, recruit top bankers, preserve our historically conservative credit culture, and provide shareholders with stable earnings throughout credit cycles.

During the past five years, we have supplemented our organic growth and leveraged our strong deposit base with strategic acquisitions, primarily to assist with our growth in the Dallas/Fort Worth and Houston regions. The following table summarizes, with fair value historical balances at the date of acquisition, our whole bank acquisitions during the last five years.

Institution Acquired	Location	Date Completed	Acquired Assets	Acquired Loans	Acquired Deposits	Number of Branches
(Dollars in thousands)						
Westbound Bank	Houston MSA	June 2018	\$216,059	\$154,687	\$181,421	4
Texas Leadership Bank	Dallas/Fort Worth MSA	April 2015	\$76,715	\$43,568	\$65,496	1
DCB Financial	Dallas/Fort Worth MSA	March 2015	\$130,170	\$118,154	\$94,451	2

Since our initial expansion outside of East Texas in 2013, we have grown our network of banking locations from 18 banking locations in 11 Texas communities to 30 banking locations in 24 Texas communities.

Our Community Banking Philosophy and Culture

We focus on a community-based relationship model, as opposed to a line of business model, because we believe the community-based relationship model promotes an entrepreneurial attitude within our Company while

providing personal attention and solutions tailored to our customers. Our culture is one of employee ownership and it is something we take very seriously. In 2016, we formally documented our culture in a book called “The Guaranty Culture,” which we give to all prospective new hires and directors before they join our team so that they clearly understand who we are, how we work, what we believe, how we make decisions and what we admire in people. We believe a great bank requires the right amount of two forms of capital: financial and human. We understand that our ability to successfully deploy our financial capital is directly related to our ability to bring the right talents together to lead our teams. This focus on human capital has rewarded us with a cohesive group of directors, officers and employees that we believe is our greatest asset. We have invested in a robust leadership development program designed to develop comprehensive bankers who understand all aspects of our operations and embrace our core values. The training program generally lasts 12-18 months and includes rotations through each primary department of the Bank. Successful graduates of our training program are typically promoted to a managerial position upon completion and we currently have graduates in management, lending and operational roles. Several of the Bank’s market presidents and managers are graduates of our training program.

We have developed a network of banking locations strategically positioned in separate and distinct communities. Each community where we have a banking location is overseen by a local market president or manager, and we emphasize local decision-making by experienced bankers supported by centralized risk and credit oversight. We believe that employing local decision makers, supported by industry-leading technology and centralized operational and credit administration support from our corporate headquarters, allows us to serve our customers’ individual needs while managing risk on a uniform basis. We intend to repeat this scalable model in each market in which we are able to identify high-caliber bankers with a strong banking team. We empower these bankers to implement our operating strategy, grow our customer base and provide the highest level of customer service possible. We believe our organizational approach enables us to attract and retain talented bankers and banking teams who desire the combination of the Bank’s size and loan limits, dedication to culture, commitment to our communities, local decision-making authority, compensation structure and focus on relationship banking.

Growth and Expansion Strategies

Our strategic plan is to be a leading Texas bank holding company with a commitment to operate as a community bank as we continue to execute our expansion strategy. Our expansion strategy is to generate shareholder value through the following:

Maintain Focus on Organic Growth. Focusing on organic growth is a strategy that allows us to generate stable funding sources without the non-amortizing goodwill assets and core deposit intangibles that strategic acquisitions might add to our balance sheet. We believe that core deposits have become significantly more valuable and desirable because the ability to attract core deposits at a low cost has diminished as interest rates have increased and alternative funding sources have become more expensive. As such, we also believe that our significant core deposit franchise in East Texas provides a stable funding source for meaningful loan growth in existing and new markets.

Pursue Strategic Acquisitions. We intend to continue to grow through strategic acquisitions within our current markets and in other complementary markets, like our recent acquisition in the Houston MSA in June 2018. We seek acquisitions that provide meaningful financial benefits through long-term organic growth opportunities and expense reductions, while maintaining our current risk profile. We believe that many smaller financial institutions will consider us an ideal long-term partner due to our community banking philosophy, commitment to employee stock ownership and our culture of teamwork.

Establish De Novo Banking Locations. We intend to open de novo banking locations in our existing and other attractive markets in Texas to further diversify our banking location network. In 2017, we opened de novo banking locations in each of Austin and Fort Worth, Texas.

Maintain Earnings Streams. We seek to maintain asset quality in a manner that allows us to maintain our current earnings streams, while also providing additional services to our customers in order to augment and diversify our revenue sources. For the year ended December 31, 2018, noninterest income represented approximately \$15.3 million, or 18.2%, of our total revenue of \$84.2 million (defined as net interest income plus noninterest income).

The charts below illustrate our meaningful asset, loan, deposit and net income growth for the last five years:

2

Although we are devoting substantial resources in furtherance of our expansion strategy, there are no assurances that we will be able to further implement our expansion strategy or that any of the components of our expansion strategy will be successful.

We believe the following competitive strengths support our growth and expansion strategy:

Experienced Executive Management Team. The Bank has a seasoned and experienced executive management team with more than 285 years of experience in financial services businesses. Our executive management team has successfully managed profitable organic growth, executed acquisitions, developed a strong credit culture and implemented a relationship-based approach to commercial and consumer banking. In addition, our executive management team has extensive knowledge of the bank regulatory landscape, significant experience navigating interest rate and credit cycles and a long history of working together.

Employee Ownership Mentality. As of December 31, 2018, our Company only directors, our executive officers and our employee stock ownership plan, or KSOP, as a group, beneficially owned approximately 29.2% of our outstanding shares of common stock. Our KSOP owned 11.3% of our outstanding shares. Many of our employees' interests in the KSOP represent material portions of their net worth, particularly our long-tenured employees. We believe that the KSOP's material ownership position promotes an owner-operator mentality among our employees, from senior officers to entry-level employees, which we believe enhances our employees' dedication to our organization and the execution of our strategy.

Proven Successful Execution of Growth Strategies. We have developed a strategic growth plan that allows the Company to quickly identify and efficiently execute corporate transactions that we believe enhance our geographic footprint and enterprise value. Since 2011, we have successfully integrated ten acquired locations into our Company through what we believe is an effective combination of comprehensive integration planning, extensive management experience with expansion, and a welcoming and flexible culture of employee ownership. In that same time period, we also established eight de novo locations outside of our historical East Texas market, achieving our objectives for organic growth within our anticipated time periods and successfully integrating new local management teams and employees into our Company. Accordingly,

we have a proven track record of executing value-added acquisitions and achieving consistent, meaningful organic growth.

Scalable Platform. Utilizing the significant prior experience of our management team and employees, we believe that we have built a strong and scalable operational platform, including technology and banking processes and infrastructure, capable of supporting future organic growth and acquisitions when the right opportunities arise. We maintain operational systems and staffing that we believe are stronger than necessarily required for a financial institution of our size in order to successfully execute integrations when needed and accommodate future growth without a commensurate need for expansion of our back office capabilities. We believe our platform allows us to focus on growing the revenue-generating divisions of our business while maintaining our operational efficiencies, resulting in improved profitability.

Disciplined Credit Culture and Robust Risk Management Systems. We seek to prudently mitigate and manage our risks through a disciplined, enterprise-wide approach to risk management, particularly credit, compliance, operational and interest rate risk. All of the Bank's executive officers serve on the Bank's Enterprise Risk Management Committee. We endeavor to maintain asset quality through an emphasis on local market knowledge, long-term customer relationships, consistent and thorough underwriting for all loans and a conservative credit culture.

Brand Strength and Reputation. We believe our brand recognition, including the Guaranty name and our iconic "G" logo, which is prominently displayed in all of our advertising and marketing materials and has been trademarked to preserve its integrity, is an important element of our business model and a key driver of our future growth. We believe our reputation for providing personal and dependable service and active community involvement is well established in our traditional East Texas market, and we are continuously striving to replicate that brand awareness and reputation in our newer markets of the Dallas/Fort Worth metroplex, Houston metroplex and Central Texas through a high level of community involvement and the targeted hiring of employees with strong relationships and reputations within these markets.

Stable Core Deposit Base. We believe our traditional East Texas market provides a historically stable source of core deposits that has become a greater source of funding as interest rates have increased and core deposits have become more difficult and more expensive to attract, especially in more competitive markets. As we enter new markets, we believe that our stable core deposit base enhances our ability to pursue loans in large, high growth markets and to fund other revenue sources such as our warehouse lending division.

Our Banking Services

Lending Activities. We offer a variety of loans, including commercial lines of credit, working capital loans, commercial real estate-backed loans (including loans secured by owner occupied commercial properties), term loans, equipment financing, acquisition, expansion and development loans, borrowing base loans, real estate construction loans, homebuilder loans, letters of credit and other loan products to small- and medium-sized businesses, real estate developers, mortgage lenders, manufacturing and industrial companies and other businesses. We also offer various consumer loans to individuals and professionals including residential real estate loans, home equity loans, installment loans, unsecured and secured personal lines of credit, and standby letters of credit. Lending activities originate from the efforts of our bankers, with an emphasis on lending to individuals, professionals, small- to medium-sized businesses and commercial companies located in our market areas. Although all lending involves a degree of risk, we believe that commercial business loans and commercial real estate loans present greater risks than other types of loans in our portfolio. We work to mitigate these risks through conservative underwriting policies and consistent monitoring of credit quality indicators.

We adhere to what we believe are disciplined underwriting standards, but also remain cognizant of the need to serve the credit needs of customers in our primary market areas by offering flexible loan solutions in a responsive and timely manner. We maintain asset quality through an emphasis on local market knowledge, long-term customer relationships, consistent and thorough underwriting for all loans and a conservative credit culture. We also seek to maintain a broadly diversified loan portfolio across customer, product and industry types. Our lending policies do not provide for any loans that are highly speculative, subprime, or that have high loan-to-value ratios. These components, together with active credit management, are the foundation of our credit culture, which we believe is critical to enhancing the long-term value of our organization to our customers, employees, shareholders and communities.

We have a service-driven, relationship-based, business-focused credit culture, rather than a price-driven, transaction-based culture. Substantially all of our loans are made to borrowers located or operating in our primary market areas with whom we have ongoing relationships across various product lines. The limited number of loans secured by properties located in out-of-market areas have been made strictly to borrowers who are well-known to us.

Our credit approval policies provide for various levels of officer and senior management lending authority for new credits and renewals, which are based on position, capability and experience. Loans in excess of an individual officer's lending limit may be approved by two or more executive officers, with stacking authority, combining their individual lending limits, up to a current maximum of \$2.5 million. Loans presenting aggregate lending exposure in excess of \$2.5 million are subject to approval of the Bank's Directors' Loan Committee. These limits are reviewed periodically by the Bank's board of directors. We believe that our credit approval process provides for thorough underwriting and efficient decision making.

Credit risk management involves a partnership between our loan officers and our credit approval, credit administration and collections personnel. We conduct monthly loan meetings, attended by substantially all of our loan officers, related loan production staff and credit administration staff at which asset quality and delinquencies are reviewed. Our evaluation and compensation program for our loan officers includes significant goals, such as the percentages of past due loans and charge-offs to total loans in the officer's portfolio, that we believe motivate the loan officers to focus on the origination and maintenance of high quality credits consistent with our strategic focus on asset quality.

Deposit Activities. Our deposits serve as the primary funding source for lending, investing and other general banking purposes. We provide a full range of deposit products and services, including a variety of checking and savings accounts, certificates of deposit, money market accounts, debit cards, remote deposit capture, online banking, mobile banking, e-Statements, bank-by-mail and direct deposit services. We also offer business accounts and cash management services, including business checking and savings accounts and treasury management services. We solicit deposits through our relationship-driven team of dedicated and accessible bankers and through community focused marketing. We also seek to cross-sell deposit products at loan origination.

Given the diverse nature of our banking location network and our relationship-driven approach to our customers, we believe our deposit base is comparatively less sensitive to interest rate variations than our competitors. Nevertheless, we attempt to competitively price our deposit products to promote core deposit growth. We believe that our loan pricing encourages deposits from our loan customers.

Guaranty Bank & Trust Wealth Management Group. We deliver a comprehensive suite of trust services through Guaranty Bank & Trust Wealth Management Group, a division of our Bank. We provide traditional trustee, custodial and escrow services for institutional and individual accounts, including corporate escrow accounts, serving as custodian for self-directed individual retirement accounts and other retirement accounts. In addition, we offer clients comprehensive investment management solutions whereby we manage all or a portion of a client's investment portfolio on a discretionary basis. Finally, we provide retirement plan services, such as 401(k) programs, through a national vendor.

Other Products and Services. We offer banking products and services that are attractively priced with a focus on customer convenience and accessibility. We offer a full suite of online banking services including access to account balances, online transfers, online bill payment and electronic delivery of customer statements, as well as ATMs, and banking by telephone, mail and personal appointment. We also offer debit cards, night depository, direct deposit, cashier's checks, and letters of credit, as well as treasury management services, including wire transfer services, positive pay, remote deposit capture and automated clearinghouse services.

Investments

We manage our investment portfolio primarily for liquidity purposes, with a secondary focus on returns. We separate our portfolio into two categories: (1) short-term investments with maturities less than one year, including federal funds sold; and (2) investments with maturities exceeding one year (the current duration is approximately 4.7 years), all of which are classified as either available-for-sale or held-to-maturity and can be used for pledging on public deposits, selling under repurchase agreements and meeting unforeseen liquidity needs. We regularly evaluate the composition of this category as changes occur with respect to the interest rate yield curve. Although we may sell investment securities from time to time to take advantage of changes in interest rate spreads, it is our policy not to sell investment securities unless we can reinvest the proceeds at a similar or higher spread, so as not to take gains to the detriment of future income.

Our Markets

We consider our current market regions to be East Texas, Central Texas, the Dallas/Fort Worth MSA and the Houston MSA. We serve these communities from our corporate headquarters in Addison, Texas, our operational headquarters in Mount Pleasant, Texas and through a network of 15 banking locations within East Texas, four banking locations in Central Texas, seven banking locations in the Dallas/Fort Worth metroplex and four banking locations in the Houston metroplex. As part of our strategic plan, we intend to further diversify our markets through entry into other large metropolitan markets in Texas and/or continued expansion in our existing newer markets.

Competition

The banking and financial services industry is highly competitive, and we compete with a wide range of financial institutions within our markets, including local, regional and national commercial banks and credit unions. We also compete with mortgage companies, brokerage firms, consumer finance companies, mutual funds, securities firms, insurance companies, third-party payment processors, fintech companies and other financial intermediaries for certain of our products and services. Some of our competitors are not subject to the regulatory restrictions and level of regulatory supervision applicable to us.

Interest rates on loans and deposits, as well as prices on fee-based services, are typically significant competitive factors within banking and financial services industry. Many of our competitors are much larger financial institutions that have greater financial resources than we do and compete aggressively for market share. These competitors attempt to gain market share through their financial product mix, pricing strategies and banking center locations. Other important competitive factors in our industry and markets include office locations and hours, quality of customer service, community reputation, continuity of personnel and services, capacity and willingness to extend credit, and ability to offer sophisticated banking products and services. While we seek to remain competitive with respect to fees charged, interest rates and pricing, we believe that our broad and sophisticated commercial banking product suite, our high-quality customer service culture, our positive reputation and long-standing community relationships will enable us to compete successfully within our markets and enhance our ability to attract and retain customers.

Our Employees

As of December 31, 2018, we employed 454 full-time equivalent persons. We provide extensive training to our employees in an effort to ensure that our customers receive superior customer service. None of our employees are represented by any collective bargaining unit or are parties to a collective bargaining agreement. We consider our relations with our employees to be good.

Our Corporate Information

Our principal executive offices are located at 16475 Dallas Parkway, Suite 600, Addison, Texas 75001, and our telephone number is (888) 572-9881. Our website is www.gnty.com. We make available at this address, free of charge, our annual report on Form 10-K, our annual report to shareholders, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities and Exchange Act of 1934, or the Exchange Act, as soon as reasonably practicable after such material is electronically filed with, or furnished to, the Securities and Exchange Commission, or SEC. These documents are also available on the SEC's website at www.sec.gov. The information contained on or accessible from our website does not constitute part of this Annual Report on Form 10-K and is not incorporated by reference herein.

Supervision and Regulation

The U.S. banking industry is highly regulated under federal and state law. Consequently, our growth and earnings performance will be affected not only by management decisions and general and local economic conditions, but also by the statutes administered by, and the regulations and policies of, various governmental regulatory authorities. These authorities include the Federal Reserve, Federal Deposit Insurance Corporation ("FDIC"), Consumer Financial Protection Bureau ("CFPB"), Office of the Comptroller of the Currency ("OCC), Internal Revenue Service ("IRS") and state taxing authorities. The effect of these statutes, regulations and policies, and any changes to such statutes, regulations and policies, can be significant and cannot be predicted.

The material statutory and regulatory requirements that are applicable to the Company and its subsidiaries are summarized below. The description below is not intended to summarize all laws and regulations applicable to the Company and its subsidiaries, and is based upon the statutes, regulations, policies, interpretive letters and other written guidance that are in effect as of the date of this Annual Report on Form 10-K.

Guaranty Bancshares, Inc.

As a bank holding company, we are subject to regulation under the Bank Holding Company Act of 1956, or the BHC Act, and to supervision, examination and enforcement by the Federal Reserve. The BHC Act and other federal laws subject bank holding companies to particular restrictions on the types of activities in which they may engage, and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations. The Federal Reserve's jurisdiction also extends to any company that we directly or indirectly control, such as any nonbank subsidiaries and other companies in which we own a controlling investment.

Financial Services Industry Reform. On July 21, 2010, the Dodd-Frank Act was enacted. The Dodd-Frank Act broadly affects the financial services industry by implementing changes to the financial regulatory landscape aimed at strengthening the sound operation of the financial services sector, including provisions that, among other things:

- establish the CFPB, an independent organization within the Federal Reserve dedicated to promulgating and enforcing consumer protection laws applicable to all entities offering consumer financial products or services;

- apply the same leverage and risk-based capital requirements that apply to insured depository institutions to most bank holding companies, which, among other things, will require us to deduct all trust preferred securities issued on or after May 19, 2010 from our Tier 1 capital (existing trust preferred securities issued prior to May 19, 2010 for all bank holding companies with less than \$15.0 billion in total consolidated assets as of December 31, 2009 are exempt from this requirement);

- broaden the base for FDIC insurance assessments from the amount of insured deposits to average total consolidated assets less average tangible equity during the assessment period (subject to risk-based adjustments that would further reduce the assessment base for custodial banks) rather than domestic deposits;

- permanently increase FDIC deposit insurance maximum to \$250,000;

- eliminate the upper limit for the reserve ratio designated by the FDIC each year, increase the minimum designated reserve ratio of the deposit insurance fund from 1.15% to 1.35% of the estimated amount of total insured deposits by September 30, 2020 and eliminate the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds;

- permit banking organizations with less than \$15.0 billion in consolidated assets as of December 31, 2009 to include in Tier 1 capital trust preferred securities and cumulative perpetual preferred stock issued and included in Tier 1 capital prior to May 19, 2010 on a permanent basis, without any phase out;

- permit banks to engage in de novo interstate branching if the laws of the state where the new branch is to be established would permit the establishment of the branch if it were part of a bank that were chartered by such state;

- repeal the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts;

- requires bank holding companies and banks to be "well capitalized" and "well managed" in order to acquire banks located outside of their home state and requires any bank holding company electing to be treated as a financial holding company to be "well capitalized" and "well managed;"

- directs the Federal Reserve to establish interchange fees for debit cards under a "reasonable and proportional cost" per transaction standard;

- increases regulation of consumer protections regarding mortgage originations, including originator compensation, minimum repayment standards, and prepayment consideration;

- restricts the preemption of select state laws by federal banking law applicable to national banks and removes federal preemption for subsidiaries and affiliates of national banks;

- implement corporate governance revisions, including with regard to executive compensation and proxy access by shareholders, that apply to all public companies, not just financial institutions; and

- increase the authority of the Federal Reserve to examine us and any nonbank subsidiaries.

In addition, the Dodd-Frank Act addresses many investor protection, corporate governance and executive compensation matters that will affect publicly-traded companies. However, under the JOBS Act there are certain

exceptions to these requirements for so long as a publicly-traded company qualifies as an emerging growth company.

7

The requirements of the Dodd-Frank Act are still in the process of being implemented over time and most will be subject to regulations implemented over the course of several years. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies and through regulations, the full extent of the impact such requirements will have on our operations is unclear. Changes resulting from further implementation of, changes to, or repeal of the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage requirements or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements. Failure to comply with the new requirements may negatively impact our results of operations and financial condition.

Revised Rules on Regulatory Capital. Regulatory capital rules pursuant to the Basel III requirements, released in July 2013 and effective January 1, 2015, implement higher minimum capital requirements for bank holding companies and banks. These rules include a new common equity Tier 1, or CET1, capital requirement and establish criteria that instruments must meet to be considered common equity Tier 1 capital, additional Tier 1 capital or Tier 2 capital. These enhancements are designed to both improve the quality and increase the quantity of capital required to be held by banking organizations, better equipping the U.S. banking system to cope with adverse economic conditions. The revised capital rules require banks and bank holding companies to maintain a minimum CET1 capital ratio of 4.5% of risk-based assets, a total Tier 1 capital ratio of 6.0% of risk-based assets, a total capital ratio of 8.0% of risk-based assets and a leverage ratio of 4.0% of average assets.

The capital rules also require banks to maintain a CET1 capital ratio of 6.5%, a total Tier 1 capital ratio of 8.0%, a total capital ratio of 10.0% and a leverage ratio of 5.0% to be deemed “well capitalized” for purposes of certain rules and prompt corrective action requirements. The risk-based ratios include a “capital conservation buffer” of 2.5% above its minimum risk-based capital requirements that must be composed of common equity Tier 1 capital. This buffer will help to ensure that banking organizations conserve capital when it is most needed, allowing them to better weather periods of economic stress. The buffer is measured relative to risk-weighted assets. The capital conservation buffer began phasing in in January 2016 at 0.625% of risk-weighted assets and will increase by that amount each year until fully implemented in January 2019. Although these new capital ratios do not become fully phased in until 2019, the banking regulators will generally expect bank holding companies and banks to meet these requirements well ahead of that date. An institution would be subject to limitations on certain activities including payment of dividends, share repurchases and discretionary bonuses to executive officers if its capital level is below the buffered ratio.

The new capital rules also attempt to improve the quality of capital by implementing changes to the definition of capital. Among the most important changes are stricter eligibility criteria for regulatory capital instruments that would disallow the inclusion of certain instruments, such as trust preferred securities (other than grandfathered trust preferred securities such as those issued by the Company), in Tier 1 capital going forward and new constraints on the inclusion of minority interests, mortgage-servicing assets, deferred tax assets and certain investments in the capital of unconsolidated financial institutions. In addition, the new rule requires that most regulatory capital deductions be made from CET1 capital.

The Federal Reserve may also set higher capital requirements for holding companies whose circumstances warrant it. For example, holding companies experiencing internal growth or making acquisitions are expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets. At this time, the bank regulatory agencies are more inclined to impose higher capital requirements to meet well-capitalized standards and future regulatory change could impose higher capital standards as a routine matter. The Company’s regulatory capital ratios and those of the Bank are in excess of the levels established for “well-capitalized” institutions under the rules.

These rules also set forth certain changes in the methods of calculating certain risk-weighted assets, which in turn will affect the calculation of risk based ratios. Under the new rules, higher or more sensitive risk weights have been assigned to various categories of assets, including, certain credit facilities that finance the acquisition, development or construction of real property, certain exposures or credits that are 90 days past due or on non-accrual status, foreign exposures and certain corporate exposures. In addition, these rules include greater recognition of collateral and guarantees, and revised capital treatment for derivatives and repo-style transactions.

On November 21, 2018, federal regulators released a proposed rulemaking that would, if enacted, provide certain banks and their holding companies with the option to elect out of complying with the Basel III Capital Rules.

8

Under the proposal, a qualifying community banking organization would be eligible to elect the community bank leverage ratio framework if it has a community bank leverage ratio, or CBLR, greater than 9% at the time of election. A qualifying community banking organization, or QCBO, is defined as a bank, a savings association, a bank holding company or a savings and loan holding company with:

- total consolidated assets of less than \$10 billion;
- total off-balance sheet exposures (excluding derivatives other than credit derivatives and unconditionally cancelable commitments) of 25% or less of total consolidated assets;
- total trading assets and trading liabilities of 5% or less of total consolidated assets;
- MSAs of 25% or less of CBLR tangible equity; and
- temporary difference DTAs of 25% or less of CBLR tangible equity.

A QCBO may elect out of complying with the Basel III Capital Rules if, at the time of the election, the QCBO has a CBLR above 9%. The numerator of the CBLR is referred to as “CBLR tangible equity” and is calculated as the QCBO’s total capital as reported in compliance with Call Report and FR Y-9C instructions, or Reporting Instructions (prior to including non-controlling interests in consolidated subsidiaries) less:

- Accumulated other comprehensive income (referred to in the industry as AOCI);
- Intangible assets, calculated in accordance with Reporting Instructions, other than mortgage servicing assets; and
- Deferred tax assets that arise from net operating loss and tax credit carry forwards net of any related valuations allowances.

The denominator of the CBLR is the QCBO’s average assets, calculated in accordance with Reporting Instructions and less intangible assets and deferred tax assets deducted from CBLR tangible equity. The Company will continue to monitor this rulemaking. If and when the rulemaking goes into effect, the Company and the Bank will consider whether it would be possible and advantageous at that time to elect to comply with the community bank leverage ratio framework.

Imposition of Liability for Undercapitalized Subsidiaries. Bank regulators are required to take prompt corrective action to resolve problems associated with insured depository institutions whose capital declines below certain levels. In the event an institution becomes undercapitalized, it must submit a capital restoration plan. The capital restoration plan will not be accepted by the regulators unless each company having control of the undercapitalized institution guarantees the subsidiary’s compliance with the capital restoration plan up to a certain specified amount. Any such guarantee from a depository institution’s holding company is entitled to a priority of payment in bankruptcy.

The aggregate liability of the holding company of an undercapitalized bank is limited to the lesser of 5.0% of the institution’s assets at the time it became undercapitalized or the amount necessary to cause the institution to be adequately capitalized. The bank regulators have greater power in situations where an institution becomes significantly or critically undercapitalized or fails to submit a capital restoration plan. For example, a bank holding company controlling such an institution can be required to obtain prior Federal Reserve approval of proposed dividends, or might be required to consent to a consolidation or to divest the troubled institution or other affiliates.

Acquisitions by Bank Holding Companies. The BHC Act requires every bank holding company to obtain the prior approval of the Federal Reserve before it acquires all or substantially all of the assets of any bank, or ownership or control of any voting shares of any bank or bank holding company if after such acquisition it would own or control, directly or indirectly, more than 5.0% of the voting shares of such bank or bank holding company. In approving bank or bank holding company acquisitions by bank holding companies, the Federal Reserve is required to consider, among other things, the effect of the acquisition on competition, the financial condition, managerial resources and future prospects of the bank holding company and the banks concerned, the convenience and needs of the communities to be served (including the record of performance under the CRA), the effectiveness of the applicant in combating money laundering activities and the extent to which the proposed acquisition would result in greater or more concentrated risks to the stability of the U.S. banking or financial system. Our ability to make future acquisitions will depend on our ability to obtain approval for such acquisitions from the Federal Reserve. The Federal Reserve could deny our application based on the above criteria or other considerations. For example, we could be required to sell banking centers as a condition to receiving regulatory approval, which condition may not be acceptable to us or, if acceptable

to us, may reduce the benefit of a proposed acquisition.

9

Control Acquisitions. Federal and state laws, including the BHC Act and the Change in Bank Control Act, or CBCA, impose additional prior notice or approval requirements and ongoing regulatory requirements on any investor that seeks to acquire direct or indirect “control” of an FDIC-insured depository institution or bank holding company. Whether an investor “controls” a depository institution is based on all of the facts and circumstances surrounding the investment. As a general matter, an investor is deemed to control a depository institution or other company if the investor owns or controls 25.0% or more of any class of voting securities. Subject to rebuttal, an investor is presumed to control a depository institution or other company if the investor owns or controls 10.0% or more of any class of voting securities and either the depository institution or company is a public company or no other person will hold a greater percentage of that class of voting securities after the acquisition. If an investor’s ownership of our voting securities were to exceed certain thresholds, the investor could be deemed to “control” us for regulatory purposes, which could subject such investor to regulatory filings or other regulatory consequences. The requirements of the BHCA and the CBCA could limit our access to capital and could limit parties who could acquire shares of our common stock.

Regulatory Restrictions on Dividends; Source of Strength. We are regarded as a legal entity separate and distinct from Guaranty Bank & Trust. The principal source of our revenues is dividends received from Guaranty Bank & Trust. Federal law currently imposes limitations upon certain capital distributions by national banks, such as certain cash dividends, payments to repurchase or otherwise acquire its shares, payments to shareholders of another institution in a cash-out merger and other distributions charged against capital. The Federal Reserve and OCC regulate all capital distributions by the Bank directly or indirectly to the Company, including dividend payments. The Federal Reserve has issued a policy statement that provides that a bank holding company should not pay dividends unless (1) its net income over the last four quarters (net of dividends paid) has been sufficient to fully fund the dividends, (2) the prospective rate of earnings retention appears to be consistent with the capital needs, asset quality and overall financial condition of the bank holding company and its subsidiaries and (3) the bank holding company will continue to meet minimum required capital adequacy ratios. Accordingly, we should not pay cash dividends that exceed our net income in any year or that can only be funded in ways that weaken our financial strength, including by borrowing money to pay dividends.

Under Federal Reserve policy, bank holding companies have historically been required to act as a source of financial and managerial strength to each of their banking subsidiaries, and the Dodd-Frank Act codified this policy as a statutory requirement. Under this requirement, we are expected to commit resources to support Guaranty Bank & Trust, including at times when we may not be in a financial position to provide such resources. Any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary banks. As discussed below, a bank holding company, in certain circumstances, could be required to guarantee the capital restoration plan of an undercapitalized banking subsidiary. If the capital of Guaranty Bank & Trust were to become impaired, the Federal Reserve could assess us for the deficiency. If we failed to pay the assessment within three months, the Federal Reserve could order the sale of our stock in Guaranty Bank & Trust to cover the deficiency.

In the event of a bank holding company’s bankruptcy under Chapter 11 of the U.S. Bankruptcy Code, the trustee will be deemed to have assumed and will be required to cure immediately any deficit under any commitment by the debtor holding company to any of the federal banking agencies to maintain the capital of an insured depository institution, and any claim for breach of such obligation will generally have priority over most other unsecured claims.

Scope of Permissible Activities. Under the BHC Act, we are prohibited from acquiring a direct or indirect interest in or control of more than 5.0% of the voting shares of any company that is not a bank or financial holding company and from engaging directly or indirectly in activities other than those of banking, managing or controlling banks or furnishing services to or performing services for its subsidiary banks, except that we may engage in, directly or indirectly, and may own shares of companies engaged in certain activities found by the Federal Reserve to be so closely related to banking or managing and controlling banks as to be a proper incident thereto. These activities include, among others, operating a mortgage, finance, credit card or factoring company; performing certain data processing operations; providing investment and financial advice; acting as an insurance agent for certain types of credit-related insurance; leasing personal property on a full-payout, nonoperating basis; and providing certain stock brokerage and investment advisory services. In approving acquisitions or the addition of activities, the Federal Reserve considers, among other things, whether the acquisition or the additional activities can reasonably be expected

to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh such possible adverse effects as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices.

10

Notwithstanding the foregoing, the Gramm-Leach-Bliley Act, also known as the Financial Services Modernization Act of 1999, effective March 11, 2000, or the GLB Act, amended the BHC Act and eliminated the barriers to affiliations among banks, securities firms, insurance companies and other financial service providers. The GLB Act permits bank holding companies to become financial holding companies and thereby affiliate with securities firms and insurance companies and engage in other activities that are financial in nature. The GLB Act defines “financial in nature” to include, among other things, securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking activities; and activities that the Federal Reserve has determined to be closely related to banking. No regulatory approval will be required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve. We currently have no plans to make a financial holding company election, although we may make a financial holding company election in the future if we engage in any lines of business that are impermissible for bank holding companies but permissible for financial holding companies.

Safe and Sound Banking Practices. Bank holding companies are not permitted to engage in unsafe and unsound banking practices. The Federal Reserve’s Regulation Y, for example, generally requires a bank holding company to provide the Federal Reserve with prior notice of any redemption or repurchase of its own equity securities, if the consideration to be paid, together with the consideration paid for any repurchases or redemptions in the preceding year, is equal to 10.0% or more of the bank holding company’s consolidated net worth. The Federal Reserve may oppose the transaction if it believes that the transaction would constitute an unsafe or unsound practice or would violate any law or regulation. In certain circumstances, the Federal Reserve could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

The Federal Reserve has broad authority to prohibit activities of bank holding companies and their nonbanking subsidiaries which represent unsafe and unsound banking practices, result in breaches of fiduciary duty or which constitute violations of laws or regulations, and can assess civil money penalties or impose enforcement action for such activities. The penalties can be as high as \$1,000,000 for each day the activity continues.

Anti-tying Restrictions. Bank holding companies and their affiliates are prohibited from tying the provision of certain services, such as extensions of credit, to other nonbanking services offered by a bank holding company or its affiliates. Guaranty Bank & Trust, N.A.

The Bank is subject to various requirements and restrictions under the laws of the United States, and to regulation, supervision and examination by the OCC. The Bank is also an insured depository institution and, therefore, subject to regulation by the FDIC, although the OCC is the Bank’s primary federal regulator. The OCC and the FDIC have the power to enforce compliance with applicable banking statutes and regulations. Such requirements and restrictions include requirements to maintain reserves against deposits, restrictions on the nature and amount of loans that may be made and the interest that may be charged thereon and restrictions relating to investments and other activities of the Bank.

Capital Adequacy Requirements. The OCC monitors the capital adequacy of the Bank by using a combination of risk-based guidelines and leverage ratios. The OCC considers the Bank’s capital levels when taking action on various types of applications and when conducting supervisory activities related to the safety and soundness of the Bank and the banking system. Under the revised capital rules which became effective on January 1, 2015, national banks are required to maintain four minimum capital standards: (1) a Tier 1 capital to adjusted total assets ratio, or “leverage capital ratio,” of at least 4.0%, (2) a Tier 1 capital to risk-weighted assets ratio, or “Tier 1 risk-based capital ratio,” of at least 6.0%, (3) a total risk-based capital (Tier 1 plus Tier 2) to risk-weighted assets ratio, or “total risk-based capital ratio,” of at least 8.0%, and (4) a CET1 capital ratio of 4.5%. In addition, the OCC’s prompt corrective action standards discussed below, in effect, increase the minimum regulatory capital ratios for banking organizations. These capital requirements are minimum requirements. Higher capital levels may be required if warranted by the particular circumstances or risk profiles of individual institutions, or if required by the banking regulators due to the economic conditions impacting our market. For example, OCC regulations provide that higher capital may be required to take adequate account of, among other things, interest rate risk and the risks posed by concentrations of credit, nontraditional activities or securities trading activities.

Corrective Measures for Capital Deficiencies. The federal banking regulators are required by the Federal Deposit Insurance Act, or FDI Act, to take “prompt corrective action” with respect to capital-deficient institutions that

11

are FDIC-insured. Agency regulations define, for each capital category, the levels at which institutions are “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” and “critically undercapitalized.” Under the revised capital rules, which became effective on January 1, 2015, a “well capitalized” bank has a total risk-based capital ratio of 10.0% or higher, a Tier 1 risk-based capital ratio of 8.0% or higher, a leverage ratio of 5.0% or higher, a CETI capital ratio of 6.5% or higher, and is not subject to any written agreement, order or directive requiring it to maintain a specific capital level for any capital measure. An “adequately capitalized” bank has a total risk-based capital ratio of 8.0% or higher, a Tier 1 risk-based capital ratio of 6.0% or higher, a leverage ratio of 4.0% or higher (3.0% or higher if the bank was rated a composite 1 in its most recent examination report and is not experiencing significant growth), a CETI capital ratio of 4.5% or higher, and does not meet the criteria for a well-capitalized bank. A bank is “undercapitalized” if it fails to meet any one of the ratios required to be adequately capitalized.

In addition to requiring undercapitalized institutions to submit a capital restoration plan, agency regulations contain broad restrictions on certain activities of undercapitalized institutions including asset growth, acquisitions, branch establishment and expansion into new lines of business. With certain exceptions, an insured depository institution is prohibited from making capital distributions, including dividends, and is prohibited from paying management fees to control persons if the institution would be undercapitalized after any such distribution or payment.

As a national bank’s capital decreases, the OCC’s enforcement powers become more severe. A significantly undercapitalized national bank is subject to mandated capital raising activities, restrictions on interest rates paid and transactions with affiliates, removal of management and other restrictions. The OCC has very limited discretion in dealing with a critically undercapitalized national bank and is virtually required to appoint a receiver or conservator. Banks with risk-based capital and leverage ratios below the required minimums may also be subject to certain administrative actions, including the termination of deposit insurance upon notice and hearing, or a temporary suspension of insurance without a hearing in the event the institution has no tangible capital.

Branching. National banks are required by the National Bank Act to adhere to branching laws applicable to state banks in the states in which they are located. Under the Dodd-Frank Act, de novo interstate branching by national banks is permitted if, under the laws of the state where the branch is to be located, a state bank chartered in that state would have been permitted to establish a branch. Under current Texas law, banks are permitted to establish branch offices throughout Texas with prior regulatory approval. In addition, with prior regulatory approval, banks are permitted to acquire branches of existing banks located in Texas. Banks located in Texas may also branch across state lines by merging with banks or by purchasing a branch of another bank in other states if allowed by the applicable states’ laws.

Restrictions on Transactions with Affiliates and Insiders. Transactions between the Bank and its nonbanking subsidiaries and/or affiliates, including us, are subject to Section 23A and 23B of the Federal Reserve Act and Regulation W. In general, Section 23A of the Federal Reserve Act imposes limits on the amount of such transactions, and also requires certain levels of collateral for loans to affiliated parties. It also limits the amount of advances to third parties which are collateralized by the securities or obligations of the Company or its subsidiaries. Covered transactions with any single affiliate may not exceed 10.0% of the capital stock and surplus of the Bank, and covered transactions with all affiliates may not exceed, in the aggregate, 20.0% of the Bank’s capital and surplus. For a bank, capital stock and surplus refers to the bank’s Tier 1 and Tier 2 capital, as calculated under the risk-based capital guidelines, plus the balance of the allowance for credit losses excluded from Tier 2 capital. The Bank’s transactions with all of its affiliates in the aggregate are limited to 20.0% of the foregoing capital. “Covered transactions” are defined by statute to include a loan or extension of credit to an affiliate, as well as a purchase of securities issued by an affiliate, a purchase of assets (unless otherwise exempted by the Federal Reserve) from the affiliate, the acceptance of securities issued by the affiliate as collateral for a loan, and the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate. In addition, in connection with covered transactions that are extensions of credit, the Bank may be required to hold collateral to provide added security to the Bank, and the types of permissible collateral may be limited. The Dodd-Frank Act generally enhances the restrictions on transactions with affiliates, including an expansion of what types of transactions are covered transactions to include credit exposures related to derivatives, repurchase agreement and securities lending arrangements and an increase in the amount of time for which collateral requirements regarding covered transactions must be satisfied.

Affiliate transactions are also subject to Section 23B of the Federal Reserve Act which generally requires that certain transactions between the Bank and its affiliates be on terms substantially the same, or at least as favorable to the Bank, as those prevailing at the time for comparable transactions with or involving other nonaffiliated persons. The

Federal Reserve has also issued Regulation W which codifies prior regulations under Sections 23A and 23B of the Federal Reserve Act and interpretive guidance with respect to affiliate transactions.

The restrictions on loans to directors, executive officers, principal shareholders and their related interests (collectively referred to herein as “insiders”) contained in Section 22(h) of the Federal Reserve Act and in Regulation O promulgated by the Federal Reserve apply to all insured institutions and their subsidiaries and bank holding companies. These restrictions include limits on loans to one borrower and conditions that must be met before such a loan can be made. There is also an aggregate limitation on all loans to insiders and their related interests. Generally, the aggregate of these loans cannot exceed the institution’s total unimpaired capital and surplus, although a bank’s regulators may determine that a lesser amount is appropriate. Loans to senior executive officers of a bank are even further restricted. Insiders are subject to enforcement actions for accepting loans in violation of applicable restrictions.

Restrictions on Distribution of Bank Dividends and Assets. Dividends paid by the Bank have provided a substantial part of our operating funds and for the foreseeable future it is anticipated that dividends paid by the Bank to us will continue to be our principal source of operating funds. Earnings and capital adequacy requirements serve to limit the amount of dividends that may be paid by the Bank. In general terms, federal law provides that the Bank’s board of directors may, from time to time and as it deems expedient, declare a dividend out of its net profits. Generally, the total of all dividends declared in a year shall not, unless approved by the OCC, exceed the net profits of that year combined with its net profits of the past two years. At December 31, 2018, the Bank had \$30.2 million available for payment of dividends.

In addition, under the Federal Deposit Insurance Corporation Improvement Act of 1991, or FDICIA, the Bank may not pay any dividend if it is undercapitalized or the payment of the dividend would cause it to become undercapitalized. The OCC may further restrict the payment of dividends by requiring that the Bank maintain a higher level of capital than otherwise required for it to be adequately capitalized for regulatory purposes. Moreover, if, in the opinion of the OCC, the Bank is engaged in an unsound practice (which could include the payment of dividends), it may require, generally after notice and hearing, that the Bank cease such practice. The OCC has indicated that paying dividends that deplete a depository institution’s capital base to an inadequate level would be an unsafe banking practice. The OCC has also issued policy statements providing that insured depository institutions generally should pay dividends only out of current operating earnings.

Further, in the event of a liquidation or other resolution of an insured depository institution, the claims of depositors and other general or subordinated creditors are entitled to a priority of payment over the claims of holders of any obligation of the institution to its shareholders, including any depository institution holding company (such as us) or any shareholder or creditor thereof.

Incentive Compensation Guidance. The federal banking agencies have issued comprehensive guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of those organizations by encouraging excessive risk-taking. The incentive compensation guidance sets expectations for banking organizations concerning their incentive compensation arrangements and related risk-management, control and governance processes. The incentive compensation guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon three primary principles: (1) balanced risk-taking incentives, (2) compatibility with effective controls and risk management and (3) strong corporate governance. Any deficiencies in compensation practices that are identified may be incorporated into the organization’s supervisory ratings, which can affect its ability to make acquisitions or take other actions. In addition, under the incentive compensation guidance, a banking organization’s federal supervisor may initiate enforcement action if the organization’s incentive compensation arrangements pose a risk to the safety and soundness of the organization. Further, a provision of the Basel III capital standards described above would limit discretionary bonus payments to bank executives if the institution’s regulatory capital ratios fail to exceed certain thresholds. A number of federal regulatory agencies proposed rules that would require enhanced disclosure of incentive-based compensation arrangements initially in April 2011, and again in April and May 2016, but the rules have not been finalized and would mostly apply to banking organizations with over \$50 billion in total assets. The scope and content of the U.S. banking regulators’ policies on executive compensation are continuing to develop and are likely to continue evolving in the near future.

Audit Reports. For insured institutions with total assets of \$1.0 billion or more, financial statements prepared in accordance with GAAP, management's certifications signed by our and the Bank's chief executive officer and chief accounting or financial officer concerning management's responsibility for the financial statements, and an attestation by the auditors regarding the Bank's internal controls must be submitted. For institutions with total assets of more

than \$3.0 billion, independent auditors may be required to review quarterly financial statements. FDICIA requires that the Bank have an independent audit committee, consisting of outside directors only, or that we have an audit committee that is entirely independent. The committees of such institutions must include members with experience in banking or financial management, must have access to outside counsel and must not include representatives of large customers. The Bank's audit committee consists entirely of independent directors.

Deposit Insurance Assessments. The FDIC insures the deposits of federally insured banks up to prescribed statutory limits for each depositor through the Deposit Insurance Fund and safeguards the safety and soundness of the banking and thrift industries. The maximum amount of deposit insurance for banks and savings institutions is \$250,000 per depositor. The amount of FDIC assessments paid by each insured depository institution is based on its relative risk of default as measured by regulatory capital ratios and other supervisory factors and is calculated based on an institution's average consolidated total assets minus average tangible equity.

We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. At least semi-annually, the FDIC will update its loss and income projections for the Deposit Insurance Fund and, if needed, will increase or decrease assessment rates, following notice-and-comment rulemaking, if required. If there are additional bank or financial institution failures or if the FDIC otherwise determines to increase assessment rates, the Bank may be required to pay higher FDIC insurance premiums. Any future increases in FDIC insurance premiums may have a material and adverse effect on our earnings.

In addition, all FDIC-insured institutions are required to pay assessments to the FDIC to fund interest payments on bonds issued by the Financing Corporation, or FICO, an agency of the federal government established to recapitalize the predecessor to the Deposit Insurance Fund. These assessments, which are included in Deposit Insurance Premiums on the Consolidated Statements of Income, will continue until the FICO bonds mature between 2017 and 2019.

Financial Modernization. Under the GLB Act, banks may establish financial subsidiaries and engage, subject to limitations on investment, in activities that are financial in nature, other than insurance underwriting as principal, insurance company portfolio investment, real estate development, real estate investment, annuity issuance and merchant banking activities. To do so, a bank must be well capitalized, well managed and have a CRA rating from its primary federal regulator of satisfactory or better. Subsidiary banks of financial holding companies or banks with financial subsidiaries must remain well capitalized and well managed in order to continue to engage in activities that are financial in nature without regulatory actions or restrictions. Such actions or restrictions could include divestiture of the "financial in nature" subsidiary or subsidiaries. In addition, a financial holding company or a bank may not acquire a company that is engaged in activities that are financial in nature unless each of the subsidiary banks of the financial holding company or the bank has a CRA rating of satisfactory or better. Neither we nor the Bank maintains a financial subsidiary.

Brokered Deposit Restrictions. Insured depository institutions that are categorized as adequately capitalized institutions under the FDI Act and corresponding federal regulations cannot accept, renew or roll over brokered deposits, without receiving a waiver from the FDIC, and are subject to restrictions on the interest rates that can be paid on any deposits. Insured depository institutions that are categorized as undercapitalized capitalized institutions under the FDI Act and corresponding federal regulations may not accept, renew, or roll over brokered deposits. The Bank is not currently subject to such restrictions.

Concentrated Commercial Real Estate Lending Regulations. The federal banking regulatory agencies have promulgated guidance governing financial institutions with concentrations in commercial real estate lending. The guidance provides that a bank has a concentration in commercial real estate lending if (1) total reported loans for acquisition, construction, land development, and other land represent 100.0% or more of total capital or (2) total reported loans secured by multifamily and nonfarm residential properties and loans for acquisition, construction, land development, and other land represent 300.0% or more of total capital and the bank's commercial real estate loan portfolio has increased 50% or more during the prior 36 months. Owner occupied loans are excluded from this second category. If a concentration is present, management must employ heightened risk management practices that address, among other things, Board and management oversight and strategic planning, portfolio management, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing, and maintenance of increased capital levels as needed to support the level of commercial real estate lending. We are currently operating with real estate loan portfolios within such percentage levels.

Community Reinvestment Act. The CRA and the regulations issued thereunder are intended to encourage banks to help meet the credit needs of their entire assessment area, including low and moderate income neighborhoods, consistent with the safe and sound operations of such banks. These regulations also provide for regulatory assessment of a bank's record in meeting the needs of its assessment area when considering applications to establish branches, merger applications and applications to acquire the assets and assume the liabilities of another bank. FIRREA requires federal banking agencies to make public a rating of a bank's performance under the CRA. In the case of a bank holding company, the CRA performance record of the banks involved in the transaction are reviewed in connection with the filing of an application to acquire ownership or control of shares or assets of a bank or to merge with any other bank holding company. An unsatisfactory CRA record could substantially delay approval or result in denial of an application. The Bank received a "satisfactory" rating in its most recent CRA examination.

Consumer Laws and Regulations. The Bank is subject to numerous laws and regulations intended to protect consumers in transactions with the Bank. These laws include, among others, laws regarding unfair, deceptive and abusive acts and practices, usury laws, and other federal consumer protection statutes. These federal laws include the Electronic Fund Transfer Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, the Real Estate Procedures Act of 1974, the S.A.F.E. Mortgage Licensing Act of 2008, the Truth in Lending Act and the Truth in Savings Act, among others. Many states and local jurisdictions have consumer protection laws analogous, and in addition, to those enacted under federal law. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits, making loans and conducting other types of transactions. Failure to comply with these laws and regulations could give rise to regulatory sanctions, customer rescission and registration rights, action by state and local attorneys general and civil or criminal liability.

In addition, the Dodd-Frank Act created the CFPB. The CFPB has broad authority to regulate the offering and provision of consumer financial products. The CFPB officially came into being on July 21, 2011, and rulemaking authority for a range of consumer financial protection laws (such as the Truth in Lending Act, the Electronic Funds Transfer Act and the Real Estate Settlement Procedures Act, among others) transferred from the Federal Reserve and other federal regulators to the CFPB on that date. The Dodd-Frank Act gives the CFPB authority to supervise and examine depository institutions with more than \$10.0 billion in assets for compliance with these federal consumer laws. The authority to supervise and examine depository institutions with \$10.0 billion or less in assets for compliance with federal consumer laws remains largely with those institutions' primary regulators. However, the CFPB may participate in examinations of these smaller institutions on a "sampling basis" and may refer potential enforcement actions against such institutions to their primary regulators. Accordingly, the CFPB may participate in examinations of the Bank, which currently has assets of less than \$10.0 billion, and could supervise and examine our other direct or indirect subsidiaries that offer consumer financial products or services. The CFPB also has supervisory and examination authority over certain nonbank institutions that offer consumer financial products. The Dodd-Frank Act identifies a number of covered nonbank institutions, and also authorizes the CFPB to identify additional institutions that will be subject to its jurisdiction. In addition, the Dodd-Frank Act permits states to adopt consumer protection laws and regulations that are stricter than those regulations promulgated by the CFPB, and state attorneys general are permitted to enforce consumer protection rules adopted by the CFPB against certain institutions.

Mortgage Lending Rules. The Dodd-Frank Act authorized the CFPB to establish certain minimum standards for the origination of residential mortgages, including a determination of the borrower's ability to repay. Under the Dodd-Frank Act, financial institutions may not make a residential mortgage loan unless they make a "reasonable and good faith determination" that the consumer has a "reasonable ability" to repay the loan. The Dodd-Frank Act allows borrowers to raise certain defenses to foreclosure but provides a full or partial safe harbor from such defenses for loans that are "qualified mortgages." On January 10, 2013, the CFPB published final rules to, among other things, specify the types of income and assets that may be considered in the ability-to-repay determination, the permissible sources for income verification, and the required methods of calculating the loan's monthly payments. Since then the CFPB made certain modifications to these rules. The rules extend the requirement that creditors verify and document a borrower's income and assets to include all information that creditors rely on in determining repayment ability. The rules also provide further examples of third-party documents that may be relied on for such verification, such as government records and check-cashing or funds-transfer service receipts. The new rules became effective on January

10, 2014. The rules also define “qualified mortgages,” imposing both underwriting standards - for example, a borrower’s debt-to-income ratio may not exceed 43.0% - and limits on the terms of their loans. Points and fees are subject to a relatively stringent cap, and the terms include a wide array of payments that may be made in the course of closing a loan. Certain loans, including interest-only loans and negative amortization loans, cannot be qualified mortgages.

Anti-Money Laundering and OFAC. Under federal law, including the Bank Secrecy Act, or BSA, and the USA PATRIOT Act of 2001, certain financial institutions, such as the Bank, must maintain anti-money laundering programs that include established internal policies, procedures and controls; a designated BSA officer; an ongoing employee training program; and testing of the program by an independent audit function. Financial institutions are also prohibited from entering into specified financial transactions and account relationships and must meet enhanced standards for due diligence and customer identification especially in their dealings with foreign financial institutions and foreign customers. Financial institutions must take reasonable steps to conduct enhanced scrutiny of account relationships to guard against money laundering and to report any suspicious transactions, and law enforcement authorities have been granted increased access to financial information maintained by financial institutions. The Financial Crimes Enforcement Network, or FinCEN, issued final rules under the BSA in July 2016 that clarify and strengthen the due diligence requirements for banks with regard to their customers, which must be complied with no later than May 2018.

The Office of Foreign Assets Control, or OFAC, administers laws and Executive Orders that prohibit U.S. entities from engaging in transactions with certain prohibited parties. OFAC publishes lists of persons and organizations suspected of aiding, harboring or engaging in terrorist acts, known as Specially Designated Nationals and Blocked Persons. Generally, if a bank identifies a transaction, account or wire transfer relating to a person or entity on an OFAC list, it must freeze the account or block the transaction, file a suspicious activity report and notify the appropriate authorities.

Bank regulators routinely examine institutions for compliance with these obligations and they must consider an institution's compliance in connection with the regulatory review of applications, including applications for bank mergers and acquisitions. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing and comply with OFAC sanctions, or to comply with relevant laws and regulations, could have serious legal, reputational and financial consequences for the institution.

Privacy. The federal banking regulators have adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to non-affiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a non-affiliated third party. These regulations affect how consumer information is transmitted through financial services companies and conveyed to outside vendors. In addition, consumers may also prevent disclosure of certain information among affiliated companies that is assembled or used to determine eligibility for a product or service, such as that shown on consumer credit reports and asset and income information from applications. Consumers also have the option to direct banks and other financial institutions not to share information about transactions and experiences with affiliated companies for the purpose of marketing products or services. In addition to applicable federal privacy regulations, the Bank is subject to certain state privacy laws.

Federal Home Loan Bank System. The FHLB system, of which the Bank is a member, consists of 12 regional FHLBs governed and regulated by the Federal Housing Finance Board, or FHFB. The FHLBs serve as reserve or credit facilities for member institutions within their assigned regions. The reserves are funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB system. The FHLBs make loans (i.e., advances) to members in accordance with policies and procedures established by the FHLB and the Boards of directors of each regional FHLB.

As a system member, according to currently existing policies and procedures, the Bank is entitled to borrow from the Dallas FHLB provided it posts acceptable collateral. The Bank is also required to own a certain amount of capital stock in the FHLB. The Bank is in compliance with the stock ownership rules with respect to such advances, commitments and letters of credit and collateral requirements with respect to home mortgage loans and similar obligations. All loans, advances and other extensions of credit made by the FHLB to the Bank are secured by a portion of the respective mortgage loan portfolio, certain other investments and the capital stock of the FHLB held by the Bank.

Enforcement Powers. The federal banking agencies, including our primary federal regulator, the OCC, have broad enforcement powers, including the power to terminate deposit insurance, impose substantial fines and other civil and criminal penalties, and appoint a conservator or receiver. Failure to comply with applicable laws, regulations and supervisory agreements, breaches of fiduciary duty or the maintenance of unsafe and unsound conditions or practices

could subject the Company or the Bank and their subsidiaries, as well as their respective officers, directors, and other institution-affiliated parties, to administrative sanctions and potentially substantial civil money penalties. For example, the regulatory authorities may appoint the FDIC as conservator or receiver for a banking institution (or the FDIC may appoint itself, under certain circumstances) if any one or more of a number of circumstances exist, including, without limitation, the fact that the banking institution is undercapitalized and has no reasonable prospect of becoming

adequately capitalized, fails to become adequately capitalized when required to do so, fails to submit a timely and acceptable capital restoration plan or materially fails to implement an accepted capital restoration plan.

Effect of Governmental Monetary Policies

The commercial banking business is affected not only by general economic conditions but also by U.S. fiscal policy and the monetary policies of the Federal Reserve. Some of the instruments of monetary policy available to the Federal Reserve include changes in the discount rate on member bank borrowings, the fluctuating availability of borrowings at the “discount window,” open market operations, the imposition of and changes in reserve requirements against member banks’ deposits and certain borrowings by banks and their affiliates and assets of foreign branches. These policies influence to a significant extent the overall growth of bank loans, investments, and deposits and the interest rates charged on loans or paid on deposits. We cannot predict the nature of future fiscal and monetary policies or the effect of these policies on our operations and activities, financial condition, results of operations, growth plans or future prospects.

New Banking Reform Legislation

The Economic Growth, Regulatory Relief, and Consumer Protection Act, or the EGRRCPA, directs the federal banking agencies to develop a specified CBLR of not less than 8% and not more than 10%. Banks and bank holding companies with less than \$10 billion in total assets that maintain capital in excess of this ratio will be deemed to be in compliance with all other capital and leverage requirements. Federal banking agencies may consider a company’s risk profile when evaluating whether it qualifies as a community bank for purposes of the Community Bank Leverage Ratio.

Other key provisions of the EGRRCPA as it relates to community banks and bank holding companies include, but are not limited to: (i) designating mortgages held in portfolio as “qualified mortgages” for banks with less than \$10 billion in assets, subject to certain documentation and product limitations; (ii) exempting banks with less than \$10 billion in assets (and total trading assets and trading liabilities of 5% or less of total assets) from Volcker Rule requirements relating to proprietary trading; (iii) simplifying capital calculations for banks with less than \$10 billion in assets by requiring federal banking agencies to establish a community bank leverage ratio of tangible equity to average consolidated assets of not less than 8% or more than 10%, and provide that banks that maintain tangible equity in excess of such ratio will be deemed to be in compliance with risk-based capital and leverage requirements; (iv) assisting smaller banks with obtaining stable funding by providing an exception for reciprocal deposits from FDIC restrictions on acceptance of brokered deposits; (v) raising the eligibility for use of short-form Call Reports from \$1 billion to \$5 billion in assets; (vi) clarifying definitions pertaining to HVCRE, which require higher capital allocations, so that only loans with increased risk are subject to higher risk weightings; and (vii) changing the eligibility for use of the small bank holding company policy statement from institutions with under \$1 billion in assets to institutions with under \$3 billion in assets.

At this time, it is difficult to anticipate the continued impact this expansive legislation will have on the Company, its customers and the financial industry generally. To the extent the Dodd-Frank Act remains in place or is not further amended, it is likely to continue to increase the Company’s cost of doing business, limit the Bank’s permissible activities, and affect the competitive balance within the industry and market.

Impact of Current Laws and Regulations

The cumulative effect of these laws and regulations, while providing certain benefits, adds significantly to the cost of our operations and thus have a negative impact on our profitability. There has also been a notable expansion in recent years of financial service providers that are not subject to the examination, oversight, and other rules and regulations to which we are subject. Those providers, because they are not so highly regulated, may have a competitive advantage over us and may continue to draw large amounts of funds away from traditional banking institutions, with a continuing adverse effect on the banking industry in general.

Future Legislation and Regulatory Reform

In light of current economic conditions, regulators have increased their focus on the regulation of financial institutions. From time to time, various legislative and regulatory initiatives are introduced in Congress and state legislatures. New regulations and statutes are regularly proposed that contain wide-ranging proposals for altering the structures, regulations and competitive relationships of financial institutions operating in the United States. We cannot

predict whether or in what form any proposed regulation or statute will be adopted or the extent to which our business may be affected by any new regulation or statute. Future legislation, regulation and policies, and the effects of that legislation and regulation and those policies, may have a significant influence on our operations and activities, financial condition, results of operations, growth plans or future prospects and the overall growth and distribution of loans, investments and deposits. Such legislation, regulation and policies have had a significant effect on the operations and activities, financial condition, results of operations, growth plans and future prospects of commercial banks in the past and are expected to continue to do so.

ITEM 1A. RISK FACTORS

Investing in our common stock involves a high degree of risk. Before you decide to invest in our common stock, you should carefully consider the risks described below, together with all other information included in this Annual Report on Form 10 K, including the disclosures in “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and the related notes included in “Item 8. Financial Statements and Supplementary Data.” We believe the risks described below are the risks that are material to us as of the date of this Annual Report on Form 10 K. If any of the following risks actually occur, our business, financial condition, results of operations and growth prospects could be materially and adversely affected. In that case, you could experience a partial or complete loss of your investment.

Risks Related to Our Business

We may not be able to implement aspects of our expansion strategy, which may adversely affect our ability to maintain our historical earnings trends.

Our expansion strategy focuses on organic growth, supplemented by strategic acquisitions and expansion of the Bank’s banking location network, or de novo branching. We may not be able to execute on aspects of our expansion strategy, which may impair our ability to sustain our historical rate of growth or prevent us from growing at all. More specifically, we may not be able to generate sufficient new loans and deposits within acceptable risk and expense tolerances, obtain the personnel or funding necessary for additional growth or find suitable acquisition candidates. Various factors, such as economic conditions and competition with other financial institutions, may impede or prohibit the growth of our operations, the opening of new banking locations and the consummation of acquisitions. Further, we may be unable to attract and retain experienced bankers, which could adversely affect our growth. The success of our strategy also depends on our ability to effectively manage growth, which is dependent upon a number of factors, including our ability to adapt our credit, operational, technology and governance infrastructure to accommodate expanded operations. If we fail to implement one or more aspects of our strategy, we may be unable to maintain our historical earnings trends, which could have an adverse effect on our business, financial condition and results of operations.

We may not be able to manage the risks associated with our anticipated growth and expansion through de novo branching.

Our business strategy includes evaluating strategic opportunities to grow through de novo branching, and we believe that banking location expansion has been meaningful to our growth since inception. De novo branching carries with it certain potential risks, including significant startup costs and anticipated initial operating losses; an inability to gain regulatory approval; an inability to secure the services of qualified senior management to operate the de novo banking location and successfully integrate and promote our corporate culture; poor market reception for de novo banking locations established in markets where we do not have a preexisting reputation; challenges posed by local economic conditions; challenges associated with securing attractive locations at a reasonable cost; and the additional strain on management resources and internal systems and controls. Failure to adequately manage the risks associated with our anticipated growth through de novo branching could have an adverse effect on our business, financial condition and results of operations.

We may not be able to overcome the integration and other risks associated with acquisitions, which could have an adverse effect on our ability to implement our business strategy.

Although we plan to continue to grow our business organically and through de novo branching, we also intend to pursue acquisition opportunities that we believe complement our activities and have the ability to enhance our

profitability and provide attractive risk-adjusted returns. Our acquisition activities could be material to our business and involve a number of risks, including the following:

18

- intense competition from other banking organizations and other acquirers for potential merger candidates;
- market pricing for desirable acquisitions resulting in returns that are less attractive than we have traditionally sought to achieve;
- incurring time and expense associated with identifying and evaluating potential acquisitions and negotiating potential transactions, resulting in our attention being diverted from the operation of our existing business;
- using inaccurate estimates and judgments to evaluate credit, operations, management and market risks with respect to the target institution or assets;
- potential exposure to unknown or contingent liabilities of banks and businesses we acquire, including consumer compliance issues;
- the time and expense required to integrate the operations and personnel of the combined businesses;
- experiencing higher operating expenses relative to operating income from the new operations;
- losing key employees and customers;
- reputational issues if the target's management does not align with our culture and values;
- significant problems relating to the conversion of the financial and customer data of the target;
- integration of acquired customers into our financial and customer product systems;
- risks of impairment to goodwill; or
- regulatory timeframes for review of applications may limit the number and frequency of transactions we may be able to consummate.

Depending on the condition of any institution or assets or liabilities that we may acquire, that acquisition may, at least in the near term, adversely affect our capital and earnings and, if not successfully integrated with our organization, may continue to have such effects over a longer period. We may not be successful in overcoming these risks or any other problems encountered in connection with pending or potential acquisitions, and any acquisition we may consider will be subject to prior regulatory approval. Our inability to overcome these risks could have an adverse effect on our ability to implement our business strategy, which, in turn, could have an adverse effect on our business, financial condition and results of operations.

A key piece of our expansion strategy is a focus on decision-making authority at the branch and market level, and our business, financial condition, results of operations and prospects could be adversely affected if our local teams do not follow our internal policies or are negligent in their decision-making.

In order to be able to provide the responsive and individualized customer service that distinguishes us from competitors and in order to attract and retain management talent, we empower our local management teams to make certain business decisions on the local level. Lending authorities are assigned to branch presidents and their banking teams based on their experience, with all loan relationships in excess of internal specified maximums being reviewed by the Bank's Directors' Loan Committee, comprised of senior management of the Bank, or the Bank's board of directors, as the case may be. Our local lenders may not follow our internal procedures or otherwise act in our best interests with respect to their decision-making. A failure of our employees to follow our internal policies, or actions taken by our employees that are negligent or not in our best interests could have an adverse effect on our business, financial condition and results of operations.

Difficult market conditions and economic trends have recently and adversely affected the banking industry and could adversely affect our business, financial condition and results of operations in the future.

We are operating in an uncertain economic environment, including generally uncertain conditions nationally and locally in our industry and markets. Although economic conditions have improved in recent years, financial institutions continue to be affected by volatility in the real estate market in some parts of the country and uncertain regulatory and interest rate conditions. We retain direct exposure to the residential and commercial real estate markets in Texas and are affected by these events. In addition, financial institutions in Texas can be affected by volatility with the oil and gas industry and significant decreases in energy prices. Although we do not have material direct exposure to the oil and gas industry, we retain some indirect exposure, as some of our customers' businesses are directly affected by volatility with the oil and gas industry and energy prices.

Our ability to assess the creditworthiness of customers and to estimate the losses inherent in our loan portfolio is made more complex by uncertain market and economic conditions. Another national economic downturn or deterioration of

conditions in our markets could result in losses beyond those that are provided for in our allowance for loan losses and lead to the following consequences:

19

- increases in loan delinquencies;
- increases in non-performing assets and foreclosures;
- decreases in demand for our products and services, which could adversely affect our liquidity position; and
- decreases in the value of the collateral securing our loans, especially real estate, which could reduce customers' borrowing power and repayment ability.

While economic conditions in Texas and the United States have improved in recent years, there can be no assurance that these conditions will continue to improve at a similar rate, or at all, or that an economic downturn will not occur again. Although real estate markets have generally stabilized in portions of the United States, including Texas, a resumption of declines in real estate values, home sales volumes and financial stress on borrowers as a result of the uncertain economic environment, including job losses, could have an adverse effect on our borrowers or their customers, which could adversely affect our business, financial condition and results of operations. In addition, volatility in the oil and gas industry and relatively low energy prices could have an adverse effect on our borrowers or their customers, including declines in real estate values and job losses, which could adversely affect our business, financial condition and results of operations.

We may not be able to adequately measure and limit our credit risk, which could lead to unexpected losses.

The business of lending is inherently risky, including risks that the principal of or interest on any loan will not be repaid timely or at all or that the value of any collateral supporting the loan will be insufficient to cover our outstanding exposure. These risks may be affected by the strength of the borrower's business sector and local, regional and national market and economic conditions. Many of our loans are made to small- to medium-sized businesses that may be less able to withstand competitive, economic and financial pressures than larger borrowers. Our risk management practices, such as monitoring the concentration of our loans within specific industries and our credit approval practices, may not adequately reduce credit risk, and our credit administration personnel, policies and procedures may not adequately adapt to changes in economic or any other conditions affecting customers and the quality of the loan portfolio. A failure to effectively measure and limit the credit risk associated with our loan portfolio could lead to unexpected losses and have an adverse effect on our business, financial condition and results of operations.

We are dependent on the use of data and modeling in our management's decision-making, and faulty data or modeling approaches could negatively impact our decision-making ability or possibly subject us to regulatory scrutiny in the future.

The use of statistical and quantitative models and other quantitative analyses is endemic to bank decision-making, and the employment of such analyses is becoming increasingly widespread in our operations. Liquidity stress testing, interest rate sensitivity analysis, and the identification of possible violations of anti-money laundering regulations are all examples of areas in which we are dependent on models and the data that underlies them. The use of statistical and quantitative models is also becoming more prevalent in regulatory compliance. While we are not currently subject to annual Dodd-Frank Act stress testing, or DFAST, and the Comprehensive Capital Analysis and Review, or CCAR, submissions, we anticipate that model-derived testing may become more extensively implemented by regulators in the future.

We anticipate data-based modeling will penetrate further into bank decision-making, particularly risk management efforts, as the capacities developed to meet rigorous stress testing requirements are able to be employed more widely and in differing applications. While we believe these quantitative techniques and approaches improve our decision-making, they also create the possibility that faulty data or flawed quantitative approaches could negatively impact our decision-making ability or, if we become subject to regulatory stress-testing in the future, adverse regulatory scrutiny. Secondly, because of the complexity inherent in these approaches, misunderstanding or misuse of their outputs could similarly result in suboptimal decision-making.

The small- to medium-sized businesses that we lend to may have fewer resources to weather adverse business developments, which may impair our borrowers' ability to repay loans.

We focus our business development and marketing strategy primarily on small- to medium-sized businesses. As of December 31, 2018, we had approximately \$1.01 billion of loans to businesses, which represents approximately

61.0% of our total loan portfolio. Small- to medium-sized businesses frequently have smaller market shares than their

20

competition, may be more vulnerable to economic downturns, often need substantial additional capital to expand or compete and may experience substantial volatility in operating results, any of which may impair a borrower's ability to repay a loan. In addition, the success of a small- and medium-sized business often depends on the management skills, talents and efforts of a small group of people, and the death, disability or resignation of one or more of these people could have an adverse effect on the business and its ability to repay its loan. If our borrowers are unable to repay their loans, our business, financial condition and results of operations could be adversely affected.

Our commercial real estate and real estate construction loan portfolio exposes us to credit risks that may be greater than the risks related to other types of loans.

As of December 31, 2018, approximately \$926.3 million, or 55.8%, of our total loans were nonresidential real estate loans (including owner occupied commercial real estate loans), which included approximately \$237.5 million, or 14.3%, of our total loans, that were construction and land development loans. These loans typically involve repayment dependent upon income generated, or expected to be generated, by the property securing the loan in amounts sufficient to cover operating expenses and debt service. The availability of such income for repayment may be adversely affected by changes in the economy or local market conditions. These loans expose a lender to greater credit risk than loans secured by other types of collateral because the collateral securing these loans is typically more difficult to liquidate due to the fluctuation of real estate values. Additionally, non-owner occupied commercial real estate loans generally involve relatively large balances to single borrowers or related groups of borrowers. Unexpected deterioration in the credit quality of our non-owner occupied commercial real estate loan portfolio could require us to increase our allowance for loan losses, which would reduce our profitability and could have an adverse effect on our business, financial condition and results of operations.

Construction and land development loans also involve risks because loan funds are secured by a project under construction and the project is of uncertain value prior to its completion. It can be difficult to accurately evaluate the total funds required to complete a project, and construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. If we are forced to foreclose on a project prior to completion, we may be unable to recover the entire unpaid portion of the loan. In addition, we may be required to fund additional amounts to complete a project, incur taxes, maintenance and compliance costs for a foreclosed property and may have to hold the property for an indeterminate period of time, any of which could adversely affect our business, financial condition and results of operations.

Because a significant portion of our loan portfolio is comprised of real estate loans, negative changes in the economy affecting real estate values and liquidity could impair the value of collateral securing our real estate loans and result in loan and other losses.

As of December 31, 2018, approximately \$1.32 billion, or 79.5%, of our total loans were loans with real estate as a primary or secondary component of collateral. Real estate values in many Texas markets have experienced periods of fluctuation over the last five years. The market value of real estate can fluctuate significantly in a short period of time. As a result, adverse developments affecting real estate values and the liquidity of real estate in our primary markets or in Texas generally could increase the credit risk associated with our loan portfolio, and could result in losses that adversely affect credit quality, financial condition and results of operations. Negative changes in the economy affecting real estate values and liquidity in our market areas could significantly impair the value of property pledged as collateral on loans and affect our ability to sell the collateral upon foreclosure without a loss or additional losses. Collateral may have to be sold for less than the outstanding balance of the loan, which could result in losses on such loans. Such declines and losses would have an adverse effect on our business, financial condition and results of operations. If real estate values decline, it is also more likely that we would be required to increase our allowance for loan losses, which would adversely affect our business, financial condition and results of operations.

Appraisals and other valuation techniques we use in evaluating and monitoring loans secured by real property, other real estate owned and repossessed personal property may not accurately describe the net value of the asset.

In considering whether to make a loan secured by real property, we generally require an appraisal of the property.

However, an appraisal is only an estimate of the value of the property at the time the appraisal is made, and, as real estate values may change significantly in value in relatively short periods of time (especially in periods of heightened economic uncertainty), this estimate may not accurately describe the net value of the real property collateral after the

loan is made. As a result, we may not be able to realize the full amount of any remaining indebtedness when

21

we foreclose on and sell the relevant property. In addition, we rely on appraisals and other valuation techniques to establish the value of our other real estate owned, or OREO, and personal property that we acquire through foreclosure proceedings and to determine certain loan impairments. If any of these valuations are inaccurate, our combined and consolidated financial statements may not reflect the correct value of our OREO, and our allowance for loan losses may not reflect accurate loan impairments. This could have an adverse effect on our business, financial condition or results of operations. As of December 31, 2018, we held OREO and repossessed property and equipment that was valued at \$0.8 million and \$1.0 million, respectively.

We engage in lending secured by real estate and may be forced to foreclose on the collateral and own the underlying real estate, subjecting us to the costs and potential risks associated with the ownership of the real property, or consumer protection initiatives or changes in state or federal law may substantially raise the cost of foreclosure or prevent us from foreclosing at all.

Since we originate loans secured by real estate, we may have to foreclose on the collateral property to protect our investment and may thereafter own and operate such property, in which case we would be exposed to the risks inherent in the ownership of real estate. As of December 31, 2018, we held approximately \$0.8 million in OREO in a special purpose subsidiary that is currently marketed for sale. The amount that we, as a mortgagee, may realize after a default is dependent upon factors outside of our control, including, but not limited to general or local economic condition, environmental cleanup liability, assessments, interest rates, real estate tax rates, operating expenses of the mortgaged properties, ability to obtain and maintain adequate occupancy of the properties, zoning laws, governmental and regulatory rules, and natural disasters. Our inability to manage the amount of costs or size of the risks associated with the ownership of real estate, or write-downs in the value of other real estate owned, could have an adverse effect on our business, financial condition and results of operations.

Additionally, consumer protection initiatives or changes in state or federal law may substantially increase the time and expense associated with the foreclosure process or prevent us from foreclosing at all. While historically Texas has had foreclosure laws that are favorable to lenders, a number of states in recent years have either considered or adopted foreclosure reform laws that make it substantially more difficult and expensive for lenders to foreclose on properties in default, and we cannot be certain that Texas will not adopt similar legislation in the future. Additionally, federal regulators have prosecuted a number of mortgage servicing companies for alleged consumer law violations. If new state or federal laws or regulations are ultimately enacted that significantly raise the cost of foreclosure or raise outright barriers, such could have an adverse effect on our business, financial condition and results of operation.

A portion of our loan portfolio is comprised of commercial loans secured by receivables, inventory, equipment or other commercial collateral, the deterioration in value of which could expose us to credit losses.

As of December 31, 2018, approximately \$261.8 million, or 15.8%, of our total loans were commercial loans to businesses. In general, these loans are collateralized by general business assets, including, among other things, accounts receivable, inventory and equipment, and most are backed by a personal guaranty of the borrower or principal. These commercial loans are typically larger in amount than loans to individuals and, therefore, have the potential for larger losses on a single loan basis. Additionally, the repayment of commercial loans is subject to the ongoing business operations of the borrower. The collateral securing such loans generally includes moveable property such as equipment and inventory, which may decline in value more rapidly than we anticipate exposing us to increased credit risk. In addition, a portion of our customer base, including customers in the energy and real estate business, may be in industries which are particularly sensitive to commodity prices or market fluctuations, such as energy prices. Accordingly, negative changes in commodity prices and real estate values and liquidity could impair the value of the collateral securing these loans. Significant adverse changes in the economy or local market conditions in which our commercial lending customers operate could cause rapid declines in loan collectability and the values associated with general business assets resulting in inadequate collateral coverage that may expose us to credit losses and could adversely affect our business, financial condition and results of operations.

Our allowance for loan losses may prove to be insufficient to absorb potential losses in our loan portfolio.

We maintain an allowance for loan losses that represents management's judgment of probable losses and risks inherent in our loan portfolio. As of December 31, 2018, our allowance for loan losses totaled \$14.7 million, which represents approximately 0.88% of our total loans. The level of the allowance reflects management's continuing evaluation of general economic conditions, diversification and seasoning of the loan portfolio, historic loss experience, identified

credit problems, delinquency levels and adequacy of collateral. The determination of the appropriate level of the allowance for loan losses is inherently highly subjective and requires us to make significant estimates of and

assumptions regarding current credit risks and future trends, all of which may undergo material changes. Inaccurate management assumptions, deterioration of economic conditions affecting borrowers, new information regarding existing loans, identification or deterioration of additional problem loans, acquisition of problem loans and other factors, both within and outside of our control, may require us to increase our allowance for loan losses. In addition, our regulators, as an integral part of their periodic examination, review our methodology for calculating, and the adequacy of, our allowance for loan losses and may direct us to make additions to the allowance based on their judgments about information available to them at the time of their examination. Further, if actual charge-offs in future periods exceed the amounts allocated to the allowance for loan losses, we may need additional provisions for loan losses to restore the adequacy of our allowance for loan losses. Finally, the measure of our allowance for loan losses is dependent on the adoption and interpretation of accounting standards. The Financial Accounting Standards Board recently issued a new credit impairment model, the Current Expected Credit Loss, or CECL model, which will become applicable to us on January 1, 2020. CECL will require financial institutions to estimate and develop a provision for credit losses at origination for the lifetime of the loan, as opposed to reserving for incurred or probable losses up to the balance sheet date. Under the CECL model, credit deterioration would be reflected in the income statement in the period of origination or acquisition of the loan, with changes in expected credit losses due to further credit deterioration or improvement reflected in the periods in which the expectation changes. Accordingly, the CECL model could require financial institutions like the Bank to increase their allowances for loan losses. Moreover, the CECL model likely would create more volatility in our level of allowance for loan losses. If we are required to materially increase our level of allowance for loan losses for any reason, such increase could adversely affect our business, financial condition and results of operations.

If we fail to maintain effective internal control over financial reporting, we may not be able to report our financial results accurately and timely, in which case our business may be harmed, investors may lose confidence in the accuracy and completeness of our financial reports, we could be subject to regulatory penalties and the price of our common stock may decline.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting and for evaluating and reporting on that system of internal control. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. As a public company, we are required to comply with the Sarbanes-Oxley Act and other rules that govern public companies. In particular, we are required to certify our compliance with Section 404 of the Sarbanes-Oxley Act beginning with our second annual report on Form 10-K, which will require us to furnish annually a report by management on the effectiveness of our internal control over financial reporting. In addition, unless we remain an emerging growth company and elect additional transitional relief available to emerging growth companies, our independent registered public accounting firm may be required to report on the effectiveness of our internal control over financial reporting beginning as of that second annual report on Form 10-K.

We will continue to periodically test and update, as necessary, our internal control systems, including our financial reporting controls. Our actions, however, may not be sufficient to result in an effective internal control environment, and any future failure to maintain effective internal control over financial reporting could impair the reliability of our financial statements which in turn could harm our business, impair investor confidence in the accuracy and completeness of our financial reports and our access to the capital markets and cause the price of our common stock to decline and subject us to regulatory penalties.

We rely heavily on our executive management team and other key employees, and we could be adversely affected by the unexpected loss of their services.

Our success depends in large part on the performance of our executive management team and other key personnel, as well as on our ability to attract, motivate and retain highly qualified senior and middle management and other skilled employees. Competition for qualified employees is intense, and the process of locating key personnel with the combination of skills, attributes and business relationships required to execute our business plan may be lengthy. We may not be successful in retaining our key employees, and the unexpected loss of services of one or more of our key personnel could have an adverse effect on our business because of their skills, knowledge of and business relationships within our primary markets, years of industry experience and the difficulty of promptly finding qualified

replacement personnel. If the services of any of our key personnel should become unavailable for any reason, we may not be able to identify and hire qualified persons on terms acceptable to us, or at all, which could have an adverse effect on our business, financial condition, results of operations and future prospects.

We earn income by originating residential mortgage loans for resale in the secondary mortgage market, and disruptions in that market could reduce our operating income.

Historically, we have earned income by originating mortgage loans for sale in the secondary market. A historical focus of our loan origination and sales activities has been to enter into formal commitments and informal agreements with larger banking companies and mortgage investors. Under these arrangements, we originate single family mortgages that are priced and underwritten to conform to previously agreed criteria before loan funding and are delivered to the investor shortly after funding. For the years ended December 31, 2018 and 2017, we earned approximately \$2.3 million and \$2.0 million, respectively, from these activities. However, in the recent past, disruptions in the secondary market for residential mortgage loans have limited the market for, and liquidity of, most mortgage loans other than conforming Fannie Mae and Federal Home Loan Mortgage Corporation, or Freddie Mac, loans. The effects of these disruptions in the secondary market for residential mortgage loans may reappear.

In addition, because government-sponsored entities like Fannie Mae and Freddie Mac, who account for a substantial portion of the secondary market, are governed by federal law, any future changes in laws that significantly affect the activity of these entities could, in turn, adversely affect our operations. In September 2008, Fannie Mae and Freddie Mac were placed into conservatorship by the federal government. The federal government has for many years considered proposals to reform Fannie Mae and Freddie Mac, but the results of any such reform and their impact on us are difficult to predict. To date, no reform proposal has been enacted.

These disruptions may not only affect us but also the ability and desire of mortgage investors and other banks to purchase residential mortgage loans that we originate. As a result, we may not be able to maintain or grow the income we receive from originating and reselling residential mortgage loans, which would reduce our operating income. Additionally, we may be required to hold mortgage loans that we originated for sale, increasing our exposure to interest rate risk and the value of the residential real estate that serves as collateral for the mortgage loan.

Delinquencies, defaults and foreclosures in residential mortgages create a higher risk of repurchases and indemnity requests.

We originate residential mortgage loans for sale to government-sponsored enterprises, such as Fannie Mae, Freddie Mac and other investors. As a part of this process, we make various representations and warranties to these purchasers that are tied to the underwriting standards under which the investors agreed to purchase the loan. If a representation or warranty proves to be untrue, we could be required to repurchase one or more of the mortgage loans or indemnify the investor. Repurchase and indemnity obligations tend to increase during weak economic times, as investors seek to pass on the risks associated with mortgage loan delinquencies to the originator of the mortgage. If we are forced to repurchase additional mortgage loans that we have previously sold to investors, or indemnify those investors, our business, financial condition and results of operations could be adversely affected.

A lack of liquidity could impair our ability to fund operations and adversely impact our business, financial condition and results of operations.

Liquidity is essential to our business. We rely on our ability to generate deposits and effectively manage the repayment and maturity schedules of our loans and investment securities, respectively, to ensure that we have adequate liquidity to fund our operations. An inability to raise funds through deposits, borrowings, the sale of our investment securities, the sale of loans, and other sources could have a substantial negative effect on our liquidity.

Our most important source of funds is deposits. As of December 31, 2018, approximately \$1.44 billion, or 76.7%, of our total deposits were demand, savings and money market accounts. Historically our savings, money market deposit accounts and demand accounts have been stable sources of funds. However, these deposits are subject to potentially dramatic fluctuations in availability or price due to certain factors that may be outside of our control, such as a loss of confidence by customers in us or the banking sector generally, customer perceptions of our financial health and general reputation, increasing competitive pressures from other financial services firms for consumer or corporate customer deposits, changes in interest rates and returns on other investment classes, which could result in significant outflows of deposits within short periods of time or significant changes in pricing necessary to maintain current customer deposits or attract additional deposits, increasing our funding costs and reducing our net interest income and net income.

The \$435.5 million remaining balance of deposits consisted of certificates of deposit, of which \$311.7 million, or 16.7% of our total deposits, were due to mature within one year. Historically, a majority of our certificates of deposit

are renewed upon maturity as long as we pay competitive interest rates. These customers are, however, interest-rate conscious and may be willing to move funds into higher-yielding investment alternatives. If customers transfer money out of the Bank's deposits and into other investments such as money market funds, we would lose a relatively low-cost source of funds, increasing our funding costs and reducing our net interest income and net income.

Other primary sources of funds consist of cash flows from operations, maturities and sales of investment securities, and proceeds from the issuance and sale of our equity and debt securities to investors. Additional liquidity is provided by our ability to borrow from the Federal Reserve Bank of Dallas and the Federal Home Loan Bank of Dallas, or the FHLB. We also may borrow funds from third-party lenders, such as other financial institutions. Our access to funding sources in amounts adequate to finance or capitalize our activities, or on terms that are acceptable to us, could be impaired by factors that affect us directly or the financial services industry or economy in general, such as disruptions in the financial markets or negative views and expectations about the prospects for the financial services industry. Our access to funding sources could also be affected by a decrease in the level of our business activity as a result of a downturn in Texas or by one or more adverse regulatory actions against us.

Any decline in available funding could adversely impact our ability to originate loans, invest in securities, meet our expenses, or fulfill obligations such as repaying our borrowings or meeting deposit withdrawal demands, any of which could, in turn, have an adverse effect on our business, financial condition and results of operations.

We may need to raise additional capital in the future, and such capital may not be available when needed or at all.

We may need to raise additional capital, in the form of additional debt or equity, in the future to have sufficient capital resources and liquidity to meet our commitments and fund our business needs and future growth, particularly if the quality of our assets or earnings were to deteriorate significantly. Our ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of our control, and our financial condition. Economic conditions and a loss of confidence in financial institutions may increase our cost of funding and limit access to certain customary sources of capital, including interbank borrowings, repurchase agreements and borrowings from the discount window of the Federal Reserve System. We may not be able to obtain capital on acceptable terms — or at all. Any occurrence that may limit our access to the capital markets, such as a decline in the confidence of debt purchasers, depositors of our bank or counterparties participating in the capital markets or other disruption in capital markets, may adversely affect our capital costs and our ability to raise capital and, in turn, our liquidity. Further, if we need to raise capital in the future, we may have to do so when many other financial institutions are also seeking to raise capital and would then have to compete with those institutions for investors. An inability to raise additional capital on acceptable terms when needed could have a material adverse effect on our business, financial condition or results of operations.

We have a concentration of deposit accounts with state and local municipalities that is a material source of our funding, and the loss of these deposits or significant fluctuations in balances held by these public bodies could force us to fund our business through more expensive and less stable sources.

As of December 31, 2018, \$229.1 million, or approximately 12.2%, of our total deposits consisted of deposit accounts of public bodies, such as state or local municipalities, or public funds. These types of deposits are often secured and typically fluctuate on a seasonal basis due to timing differences between tax collection and expenditures. Withdrawals of deposits or significant fluctuation in a material portion of our largest public fund depositors could force us to rely more heavily on borrowings and other sources of funding for our business and withdrawal demands, adversely affecting our net interest margin and results of operations. We may also be forced, as a result of any withdrawal of deposits, to rely more heavily on other, potentially more expensive and less stable funding sources. Consequently, the occurrence of any of these events could have an adverse effect on our business, financial condition and results of operations.

We are subject to interest rate risk and fluctuations in interest rates may adversely affect our earnings.

The majority of our banking assets and liabilities are monetary in nature and subject to risk from changes in interest rates. Like most financial institutions, our earnings are significantly dependent on our net interest income, the principal component of our earnings, which is the difference between interest earned by us from our interest-earning assets, such as loans and investment securities, and interest paid by us on our interest-bearing liabilities, such as deposits and borrowings. We expect that we will periodically experience “gaps” in the interest rate sensitivities of our

assets and liabilities, meaning that either our interest-bearing liabilities will be more sensitive to changes in market

25

interest rates than our interest-earning assets, or vice versa. In either event, if market interest rates should move contrary to our position, this “gap” will negatively impact our earnings. The impact on earnings is more adverse when the slope of the yield curve flattens, that is, when short-term interest rates increase more than long-term interest rates or when long-term interest rates decrease more than short-term interest rates. Many factors impact interest rates, including governmental monetary policies, inflation, recession, changes in unemployment, the money supply and international economic weakness and disorder and instability in domestic and foreign financial markets. As of December 31, 2018, approximately 47.4% of our interest-earning assets and approximately 47.6% of our interest-bearing liabilities had a variable rate. Our interest rate sensitivity profile was asset sensitive as of December 31, 2018, meaning that we estimate our net interest income would increase more from rising interest rates than from falling interest rates.

Interest rate increases often result in larger payment requirements for our borrowers, which increases the potential for default and could result in a decrease in the demand for loans. At the same time, the marketability of the property securing a loan may be adversely affected by any reduced demand resulting from higher interest rates. In a declining interest rate environment, there may be an increase in prepayments on loans as borrowers refinance their loans at lower rates. In addition, in a low interest rate environment, loan customers often pursue long-term fixed rate credits, which could adversely affect our earnings and net interest margin if rates increase. Changes in interest rates also can affect the value of loans, securities and other assets. An increase in interest rates that adversely affects the ability of borrowers to pay the principal or interest on loans may lead to an increase in nonperforming assets and a reduction of income recognized, which could have an adverse effect on our results of operations and cash flows. Further, when we place a loan on nonaccrual status, we reverse any accrued but unpaid interest receivable, which decreases interest income. At the same time, we continue to have a cost to fund the loan, which is reflected as interest expense, without any interest income to offset the associated funding expense. Thus, an increase in the amount of nonperforming assets would have an adverse impact on net interest income. If short-term interest rates continue to remain at their historically low levels for a prolonged period and assuming longer-term interest rates fall further, we could experience net interest margin compression as our interest-earning assets would continue to reprice downward while our interest-bearing liability rates could fail to decline in tandem. Such an occurrence would have an adverse effect on our net interest income and could have an adverse effect on our business, financial condition and results of operations.

Our business is concentrated in, and largely dependent upon, the continued growth and welfare of our primary markets, and adverse economic conditions in these markets could negatively impact our operations and customers. Our business, financial condition and results of operations are affected by changes in the economic conditions of our primary markets of East Texas, Central Texas and the Dallas/Fort Worth metroplex. Our success depends to a significant extent upon the business activity, population, income levels, employment trends, deposits and real estate activity in our primary markets. Economic conditions within our primary markets, and the state of Texas in general, are influenced by the energy sector generally and the price of oil and gas specifically. Although our customers’ business and financial interests may extend well beyond our primary markets, adverse conditions that affect our primary markets, including future declines in oil prices, could reduce our growth rate, affect the ability of our customers to repay their loans, affect the value of collateral underlying our loans, affect our ability to attract deposits and generally affect our business, financial condition, results of operations and future prospects. Due to our geographic concentration within our primary markets, we may be less able than other larger regional or national financial institutions to diversify our credit risks across multiple markets.

We face strong competition from financial services companies and other companies that offer banking services. We operate in the highly competitive financial services industry and face significant competition for customers from financial institutions located both within and beyond our principal markets. We compete with commercial banks, savings banks, credit unions, nonbank financial services companies and other financial institutions operating within or near the areas we serve. Additionally, certain large banks headquartered outside of our markets and large community banking institutions target the same customers we do. In addition, as customer preferences and expectations continue to evolve, technology has lowered barriers to entry and made it possible for banks to expand their geographic reach by providing services over the internet and for nonbanks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. The banking industry is experiencing rapid changes in

technology, and, as a result, our future success will depend in part on our ability to address our customers' needs by using technology. Customer loyalty can be influenced by a competitor's new products, especially offerings that could provide cost savings or a higher return to the customer. Increased lending activity of competing banks following the

recent downturn has also led to increased competitive pressures on loan rates and terms for high-quality credits. We may not be able to compete successfully with other financial institutions in our markets, and we may have to pay higher interest rates to attract deposits, accept lower yields to attract loans and pay higher wages for new employees, resulting in lower net interest margins and reduced profitability.

Many of our non-bank competitors are not subject to the same extensive regulations that govern our activities and may have greater flexibility in competing for business. The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. In addition, some of our current commercial banking customers may seek alternative banking sources as they develop needs for credit facilities larger than we may be able to accommodate. Our inability to compete successfully in the markets in which we operate could have an adverse effect on our business, financial condition or results of operations.

Our trust and wealth management division derives its revenue from noninterest income and is subject to operational, compliance, reputational, fiduciary and strategic risks that could adversely affect our business, financial condition and results of operations.

Our trust and wealth management division subjects us to a number of different risks from our commercial activities, any of which could adversely affect our business, financial condition and results of operations. Operational or compliance risk entails inadequate or failed internal processes, people and systems or changes driven by external events. Success in the trust and wealth management business is highly dependent on reputation. Damage to our reputation from negative opinion in the marketplace could adversely impact both revenue and net income. Such results could also be affected by errors in judgment by management or the board, the improper implementation of business decisions or by unexpected external events. Our success in this division is also dependent upon our continuing ability to generate investment results that satisfy our clients and attract prospective clients, which may be adversely impacted by factors that are outside of our control. In addition, our trust and wealth management division is subject to fiduciary risks and risks associated with adverse decisions regarding the scope of fiduciary liabilities. If any claims or legal actions regarding our fiduciary role are not resolved in a manner favorable to us, we may be exposed to significant financial liability and our reputation could be damaged. Either of these results may adversely impact demand for our products and services, including those unrelated to our trust and wealth management division, or otherwise have an adverse effect on our business, financial condition or results of operation.

Additional risks resulting from our mortgage warehouse lending business could have an adverse effect on our business, financial condition and results of operations.

A portion of our lending involves the origination of mortgage warehouse lines of credit. Risks associated with our mortgage warehouse loans include credit risks relating to the mortgage bankers that borrow from us, including the risk of intentional misrepresentation or fraud; changes in the market value of mortgage loans originated by the mortgage banker, the sale of which is the expected source of repayment of the borrowings under a warehouse line of credit, due to changes in interest rates during the time in warehouse; and originations of mortgage loans that are unsalable or impaired, which could lead to decreased collateral value and the failure of a purchaser of the mortgage loan to ultimately purchase the loan from the mortgage banker. Any one or a combination of these events may adversely affect our loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels, which, in turn, could adversely affect our business, financial condition and results of operations.

New lines of business, products, product enhancements or services may subject us to additional risks.

From time to time, we implement new lines of business, or offer new products and product enhancements as well as new services within our existing lines of business and we will continue to do so in the future. For example, in 2017, we established our Small Business Association lending division. We also have plans to enhance our trust and wealth management division. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In implementing, developing or marketing new lines of business, products, product enhancements or services, we may invest significant time and resources, although we may not assign the appropriate level of resources or expertise necessary to make these new lines of business, products, product enhancements or services successful or to realize their expected benefits. Further, initial timetables for the introduction and development of new lines of business, products, product enhancements or services may not be achieved, and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives and shifting market preferences, may also impact the ultimate implementation of

a new line of business or offerings of new products, product enhancements or services. Furthermore, any new line of business, product, product enhancement or service could have a significant impact on the effectiveness of our system of internal controls.

Failure to successfully manage these risks in the development and implementation of new lines of business or offerings of new products, product enhancements or services could have an adverse impact on our business, financial condition or results of operations.

Negative public opinion regarding our company or failure to maintain our reputation in the communities we serve could adversely affect our business and prevent us from growing our business.

As a community bank, our reputation within the communities we serve is critical to our success. We believe we have set ourselves apart from our competitors by building strong personal and professional relationships with our customers and being active members of the communities we serve. As such, we strive to enhance our reputation by recruiting, hiring and retaining employees who share our core values of being an integral part of the communities we serve and delivering superior service to our customers. If our reputation is negatively affected by the actions of our employees or otherwise, we may be less successful in attracting new talent and customers or may lose existing customers, and our business, financial condition and results of operations could be adversely affected. Further, negative public opinion can expose us to litigation and regulatory action and delay and impede our efforts to implement our expansion strategy, which could further adversely affect our business, financial condition and results of operations.

We could recognize losses on investment securities held in our securities portfolio, particularly if interest rates increase or economic and market conditions deteriorate.

While we attempt to invest a significant majority of our total assets in loans (our loan to asset ratio was 73.2% as of December 31, 2018), we invest a percentage of our total assets (17.5% as of December 31, 2018) in investment securities with the primary objectives of providing a source of liquidity, providing an appropriate return on funds invested, managing interest rate risk, meeting pledging requirements and meeting regulatory capital requirements. As of December 31, 2018, the fair value of our available for sale investment securities portfolio was \$233.0 million, which included a net unrealized loss of \$7.1 million. Factors beyond our control can significantly and adversely influence the fair value of securities in our portfolio. For example, fixed-rate securities are generally subject to decreases in market value when interest rates rise. Additional factors include, but are not limited to, rating agency downgrades of the securities, defaults by the issuer or individual borrowers with respect to the underlying securities, and instability in the credit markets. Any of the foregoing factors could cause other-than-temporary impairment in future periods and result in realized losses. The process for determining whether impairment is other-than-temporary usually requires difficult, subjective judgments about the future financial performance of the issuer and any collateral underlying the security in order to assess the probability of receiving all contractual principal and interest payments on the security. Because of changing economic and market conditions affecting interest rates, the financial condition of issuers of the securities and the performance of the underlying collateral, we may recognize realized and/or unrealized losses in future periods, which could have an adverse effect on our business, financial condition and results of operations.

The accuracy of our financial statements and related disclosures could be affected if the judgments, assumptions or estimates used in our critical accounting policies are inaccurate.

The preparation of financial statements and related disclosures in conformity with GAAP requires us to make judgments, assumptions and estimates that affect the amounts reported in our consolidated financial statements and accompanying notes. Our critical accounting policies, which are included in the section captioned "Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Annual Report on Form 10-K, describe those significant accounting policies and methods used in the preparation of our consolidated financial statements that we consider "critical" because they require judgments, assumptions and estimates that materially affect our consolidated financial statements and related disclosures. As a result, if future events or regulatory views concerning such analysis differ significantly from the judgments, assumptions and estimates in our critical accounting policies, those events or assumptions could have a material impact on our consolidated financial statements and related disclosures, in each case resulting in our needing to revise or restate prior period financial statements, cause damage to our reputation and the price of our common stock, and adversely affect our business, financial condition and results of operations.

There could be material changes to our financial statements and disclosures if there are changes in accounting standards or regulatory interpretations of existing standards

From time to time the Financial Accounting Standards Board or the SEC may change the financial accounting and reporting standards that govern the preparation of our financial statements. Such changes may result in us being subject to new or changing accounting and reporting standards. In addition, the bodies that interpret the accounting

standards (such as banking regulators or outside auditors) may change their interpretations or positions on how new or existing standards should be applied. These changes may be beyond our control, can be hard to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retrospectively, or apply an existing standard differently and retrospectively, in each case resulting in our needing to revise or restate prior period financial statements, which could materially change our financial statements and related disclosures, cause damage to our reputation and the price of our common stock, and adversely affect our business, financial condition and results of operations.

Our operations could be interrupted if our third-party service providers experience difficulty, terminate their services or fail to comply with banking regulations.

We outsource some of our operational activities and accordingly depend on a number of relationships with third-party service providers. Specifically, we rely on third parties for certain services, including, but not limited to, core systems support, informational website hosting, internet services, online account opening and other processing services. Our business depends on the successful and uninterrupted functioning of our information technology and telecommunications systems and third-party services. The failure of these systems, a cyber security breach involving any of our third-party service providers, or the termination or change in terms of a third-party software license or service agreement on which any of these systems is based, could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. Replacing vendors or addressing other issues with our third-party service providers could entail significant delay, expense and disruption of service.

As a result, if these third-party service providers experience difficulties, are subject to cyber security breaches, or terminate their services, and we are unable to replace them with other service providers, particularly on a timely basis, our operations could be interrupted. If an interruption were to continue for a significant period of time, our business, financial condition and results of operations could be adversely affected. Even if we are able to replace third-party service providers, it may be at a higher cost to us, which could adversely affect our business, financial condition and results of operations.

In addition, the Bank's primary federal regulator, the Office of the Comptroller of the Currency, or OCC, has recently issued guidance outlining the expectations for third-party service provider oversight and monitoring by financial institutions. The federal banking agencies, including the OCC, have recently issued enforcement actions against financial institutions for failure in oversight of third-party providers and violations of federal banking law by such providers when performing services for financial institutions. Accordingly, our operations could be interrupted if any of our third-party service providers experience difficulty, are subject to cyber security breaches, terminate their services or fail to comply with banking regulations, which could adversely affect our business, financial condition and results of operations. In addition, our failure to adequately oversee the actions of our third-party service providers could result in regulatory actions against the Bank, which could adversely affect our business, financial condition and results of operations.

System failure or cyber security breaches of our network security could subject us to increased operating costs as well as litigation and other potential losses.

Our computer systems and network infrastructure could be vulnerable to hardware and cyber security issues. Our operations are dependent upon our ability to protect our computer equipment against damage from fire, power loss, telecommunications failure or a similar catastrophic event. We could also experience a breach by intentional or negligent conduct on the part of employees or other internal sources. Any damage or failure that causes an interruption in our operations could have an adverse effect on our financial condition and results of operations. In addition, our operations are dependent upon our ability to protect our computer systems and network infrastructure, including our digital, mobile and internet banking activities, against damage from physical break-ins, cyber security breaches and other disruptive problems caused by the internet or other users. Such computer break-ins and other disruptions would jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure, which may result in significant liability, damage our reputation and inhibit the use of our internet banking services by current and potential customers. We regularly add additional security measures to our computer systems and network infrastructure to mitigate the possibility of cyber security breaches, including firewalls and

penetration testing. However, it is difficult or impossible to defend against every risk being posed by changing technologies as well as acts of cyber-crime. Increasing sophistication of cyber criminals and terrorists make keeping up with new threats difficult and could result in a system breach. Controls employed by our information technology department and cloud vendors could prove inadequate. A breach of our security that results in unauthorized access to our data

29

could expose us to a disruption or challenges relating to our daily operations, as well as to data loss, litigation, damages, fines and penalties, significant increases in compliance costs and reputational damage, any of which could have an adverse effect on our business, financial condition and results of operations.

We have a continuing need for technological change, and we may not have the resources to effectively implement new technology, or we may experience operational challenges when implementing new technology or technology needed to compete effectively with larger institutions may not be available to us on a cost effective basis.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to better serving customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend, at least in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience as well as to create additional efficiencies in our operations as we continue to grow and expand our products and service offerings. We may experience operational challenges as we implement these new technology enhancements or products, which could impair our ability to realize the anticipated benefits from such new technology or require us to incur significant costs to remedy any such challenges in a timely manner. Many of our larger competitors have substantially greater resources to invest in technological improvements. Third parties upon which we rely for our technology needs may not be able to develop on a cost effective basis systems that will enable us to keep pace with such developments. As a result, they may be able to offer additional or superior products compared to those that we will be able to provide, which would put us at a competitive disadvantage. We may lose customers seeking new technology-driven products and services to the extent we are unable to provide such products and services. Accordingly, the ability to keep pace with technological change is important and the failure to do so could adversely affect our business, financial condition and results of operations.

We are subject to certain operational risks, including, but not limited to, customer, employee or third-party fraud and data processing system failures and errors.

Employee errors and employee or customer misconduct could subject us to financial losses or regulatory sanctions and seriously harm our reputation. Misconduct by our employees could include hiding unauthorized activities from us, improper or unauthorized activities on behalf of our customers or improper use of confidential information. It is not always possible to prevent employee errors and misconduct, and the precautions we take to prevent and detect this activity may not be effective in all cases. Employee errors could also subject us to financial claims for negligence. We maintain a system of internal controls to mitigate operational risks, including data processing system failures and errors and customer or employee fraud, as well as insurance coverage designed to protect us from material losses associated with these risks, including losses resulting from any associated business interruption. If our internal controls fail to prevent or detect an occurrence, or if any resulting loss is not insured or exceeds applicable insurance limits, it could adversely affect our business, financial condition and results of operations.

In addition, we rely heavily upon information supplied by third parties, including the information contained in credit applications, property appraisals, title information, equipment pricing and valuation and employment and income documentation, in deciding which loans we will originate, as well as the terms of those loans. If any of the information upon which we rely is misrepresented, either fraudulently or inadvertently, and the misrepresentation is not detected prior to loan funding, the value of the loan may be significantly lower than expected, or we may fund a loan that we would not have funded or on terms we would not have extended. Whether a misrepresentation is made by the applicant or another third party, we generally bear the risk of loss associated with the misrepresentation. A loan subject to a material misrepresentation is typically unsellable or subject to repurchase if it is sold prior to detection of the misrepresentation. The sources of the misrepresentations are often difficult to locate, and it is often difficult to recover any of the resulting monetary losses we may suffer, which could adversely affect our business, financial condition and results of operations.

Our primary markets are susceptible to natural disasters and other catastrophes that could negatively impact the economies of our markets, our operations or our customers, any of which could have an adverse effect on us.

A significant portion of our business is generated from our primary markets of East Texas, Central Texas, the Dallas/Fort Worth MSA and the Houston MSA, which are susceptible to damage by tornadoes, floods, droughts,

hurricanes and other natural disasters and adverse weather. In addition to natural disasters, man-made events, such as acts of terror and governmental response to acts of terror, malfunction of the electronic grid and other infrastructure breakdowns, could adversely affect economic conditions in our primary markets. These catastrophic events can disrupt our operations, cause widespread property damage, and severely depress the local economies in which we operate. If the economies in our primary markets experience an overall decline as a result of a catastrophic event, demand for loans and our other products and services could be reduced. In addition, the rates of delinquencies, foreclosures, bankruptcies and losses on loan portfolios may increase substantially, as uninsured property losses or sustained job interruption or loss may materially impair the ability of borrowers to repay their loans. Moreover, the value of real estate or other collateral that secures the loans could be materially and adversely affected by a catastrophic event. A natural disaster or other catastrophic event could, therefore, result in decreased revenue and loan losses that have an adverse effect on our business, financial condition and results of operations.

We may be subject to environmental liabilities in connection with the real properties we own and the foreclosure on real estate assets securing our loan portfolio.

In the course of our business, we may purchase real estate in connection with our acquisition and expansion efforts, or we may foreclose on and take title to real estate or otherwise be deemed to be in control of property that serves as collateral on loans we make. As a result, we could be subject to environmental liabilities with respect to those properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or we may be required to investigate or clean up hazardous or toxic substances or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, if we are the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property.

The cost of removal or abatement may substantially exceed the value of the affected properties or the loans secured by those properties, we may not have adequate remedies against the prior owners or other responsible parties and we may not be able to resell the affected properties either before or after completion of any such removal or abatement procedures. If material environmental problems are discovered before foreclosure, we generally will not foreclose on the related collateral or will transfer ownership of the loan to a subsidiary. It should be noted, however, that the transfer of the property or loans to a subsidiary may not protect us from environmental liability. Furthermore, despite these actions on our part, the value of the property as collateral will generally be substantially reduced or we may elect not to foreclose on the property and, as a result, we may suffer a loss upon collection of the loan. Any significant environmental liabilities could have an adverse effect on our business, financial condition and results of operations.

We are subject to claims and litigation pertaining to intellectual property.

Banking and other financial services companies, such as our company, rely on technology companies to provide information technology products and services necessary to support their day-to-day operations. Technology companies frequently enter into litigation based on allegations of patent infringement or other violations of intellectual property rights. In addition, patent holding companies seek to monetize patents they have purchased or otherwise obtained. Competitors of our vendors, or other individuals or companies, may from time to time claim to hold intellectual property sold to us by our vendors. Such claims may increase in the future as the financial services sector becomes more reliant on information technology vendors. The plaintiffs in these actions frequently seek injunctions and substantial damages.

Regardless of the scope or validity of such patents or other intellectual property rights, or the merits of any claims by potential or actual litigants, we may have to engage in protracted litigation. Such litigation is often expensive, time-consuming, disruptive to our operations and distracting to management. If we are found to infringe one or more patents or other intellectual property rights, we may be required to pay substantial damages or royalties to a third party. In certain cases, we may consider entering into licensing agreements for disputed intellectual property, although no assurance can be given that such licenses can be obtained on acceptable terms or that litigation will not occur. These licenses may also significantly increase our operating expenses. If legal matters related to intellectual property claims were resolved against us or settled, we could be required to make payments in amounts that could have an adverse effect on our business, financial condition and results of operations.

If the goodwill that we have recorded or may record in connection with a business acquisition becomes impaired, it could require charges to earnings.

31

Goodwill represents the amount by which the cost of an acquisition exceeded the fair value of net assets we acquired in connection with the purchase of another financial institution. We review goodwill for impairment at least annually, or more frequently if a triggering event occurs which indicates that the carrying value of the asset might be impaired. Our goodwill impairment test involves a two-step process. Under the first step, the estimation of fair value of the reporting unit is compared to its carrying value including goodwill. If step one indicates a potential impairment, the second step is performed to measure the amount of impairment, if any. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Any such adjustments are reflected in our results of operations in the periods in which they become known. As of December 31, 2018, our goodwill totaled \$32.2 million. While we have not recorded any impairment charges since we initially recorded the goodwill, there can be no assurance that our future evaluations of our existing goodwill or goodwill we may acquire in the future will not result in findings of impairment and related write-downs, which could adversely affect our business, financial condition and results of operations.

We may be adversely affected by recent changes in U.S. tax laws.

The enactment of the Tax Cuts and Jobs Act, or TCJA, on December 22, 2017 made significant changes to the Internal Revenue Code, many of which are highly complex and may require interpretations and implementing regulations. As a result of the TCJA's reduction of the corporate income tax rate from 35% to 21%, we recorded a one-time, non-cash charge to income tax provision of \$1.7 million during the fourth quarter of 2017 to reduce the value of our net deferred tax assets. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Income Tax Expense." Furthermore, we may incur additional meaningful expenses (including professional fees) as the TCJA is implemented, and the expected impact of certain aspects of the statute remains unclear and subject to change.

The TCJA includes a number of provisions that will have an impact on the banking industry, borrowers and the market for residential real estate. These changes include: (i) a lower limit on the deductibility of mortgage interest on single-family residential mortgage loans, (ii) the elimination of interest deductions for home equity loans, (iii) a limitation on the deductibility of business interest expense, and (iv) a limitation on the deductibility of property taxes and state and local income taxes. The TCJA may have an adverse effect on the market for and the valuation of residential properties, as well as on the demand for such loans in the future, and could make it harder for borrowers to make their loan payments. The value of the properties securing loans in our loan portfolio may be adversely impacted as a result of the changing economics of home ownership. Such an impact could require an increase in our provision for loan losses, which would reduce our profitability and could materially adversely affect our business, financial condition and results of operations.

Risks Related to the Regulation of Our Industry

The ongoing implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, or the Dodd-Frank Act, could adversely affect our business, financial condition, and results of operations.

On July 21, 2010, the Dodd-Frank Act was signed into law, and the process of implementation is ongoing. The Dodd-Frank Act imposes significant regulatory and compliance changes on many industries, including ours. There remains significant uncertainty surrounding the manner in which the provisions of the Dodd-Frank Act will ultimately be implemented by the various regulatory agencies and the full extent of the impact of the requirements on our operations is unclear, especially in light of the Trump administration's executive order calling for a full review of the Dodd-Frank Act and the regulations promulgated under it. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, require the development of new compliance infrastructure, impose upon us more stringent capital, liquidity and leverage requirements or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements. Failure to comply with the new requirements or with any future changes in laws or regulations could adversely affect our business, financial condition and results of operations.

On May 24, 2018, the EGRRCPA became law. Among other things, the EGRRCPA changes certain of the regulatory requirements of the Dodd-Frank Act and includes provisions intended to relieve the regulatory burden on community banks. We cannot currently predict the impact of this legislation on us. Any future legislative changes could have a

material impact on our profitability, the value of assets held for investment or the value of collateral for loans.

32

Future legislative changes could also require changes to business practices and potentially expose us to additional costs, liabilities, enforcement action and reputational risk.

We operate in a highly regulated environment and the laws and regulations that govern our operations, corporate governance, executive compensation and accounting principles, or changes in them, or our failure to comply with them, could adversely affect us.

Banking is highly regulated under federal and state law. As such, we are subject to extensive regulation, supervision and legal requirements that govern almost all aspects of our operations. These laws and regulations are not intended to protect our shareholders. Rather, these laws and regulations are intended to protect customers, depositors, the Deposit Insurance Fund and the overall financial stability of the United States. These laws and regulations, among other matters, prescribe minimum capital requirements, impose limitations on the business activities in which we can engage, limit the dividend or distributions that the Bank can pay to us, restrict the ability of institutions to guarantee our debt and impose certain specific accounting requirements on us that may be more restrictive and may result in greater or earlier charges to earnings or reductions in our capital than GAAP would require. Compliance with laws and regulations can be difficult and costly, and changes to laws and regulations often impose additional operating costs. Our failure to comply with these laws and regulations, even if the failure follows good faith effort or reflects a difference in interpretation, could subject us to restrictions on our business activities, enforcement actions and fines and other penalties, any of which could adversely affect our results of operations, regulatory capital levels and the price of our securities. Further, any new laws, rules and regulations, such as the Dodd-Frank Act, could make compliance more difficult or expensive or otherwise adversely affect our business, financial condition and results of operations.

Federal banking agencies periodically conduct examinations of our business, including compliance with laws and regulations, and our failure to comply with any supervisory actions to which we are or become subject as a result of such examinations could adversely affect us.

As part of the bank regulatory process, the OCC and the Board of Governors of the Federal Reserve System, or Federal Reserve, periodically conduct examinations of our business, including compliance with laws and regulations. If, as a result of an examination, one of these federal banking agencies were to determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, asset sensitivity, risk management or other aspects of any of our operations have become unsatisfactory, or that our Company, the Bank or their respective management were in violation of any law or regulation, it may take a number of different remedial actions as it deems appropriate. These actions include the power to enjoin “unsafe or unsound” practices, to require affirmative actions to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in our capital levels, to restrict our growth, to assess civil monetary penalties against us, the Bank or their respective officers or directors, to remove officers and directors and, if it is concluded that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate the Bank’s deposit insurance. If we become subject to such regulatory actions, our business, financial condition, results of operations and reputation could be adversely affected.

We recently became subject to more stringent capital requirements, which may result in lower returns on equity, require the raising of additional capital, limit our ability to repurchase shares or pay dividends and discretionary bonuses, or result in regulatory action.

The Dodd-Frank Act requires the federal banking agencies to establish stricter risk-based capital requirements and leverage limits to apply to banks and bank and savings and loan holding companies. In July 2013, the federal banking agencies published new capital rules, referred to herein as the Basel III capital rules, which revised their risk-based and leverage capital requirements and their method for calculating risk-weighted assets. The Basel III capital rules apply to all bank holding companies with \$1.0 billion or more in consolidated assets and all banks regardless of size. The Basel III capital rules became effective as applied to us on January 1, 2015, with a phase-in period for the new capital conservation buffer that generally extends from January 1, 2015 through January 1, 2019. See the section in Item 1 of this Annual Report on Form 10-K captioned “Supervision and Regulation — Guaranty Bancshares, Inc. — New Rules on Regulatory Capital.”

As a result of the enactment of the Basel III capital rules, we became subject to increased required capital levels. Our inability to comply with these more stringent capital requirements could, among other things, result in lower returns on equity; require the raising of additional capital; limit our ability to repurchase shares or pay dividends and discretionary bonuses; or result in regulatory actions, any of which could adversely affect our business, financial condition and results of operation.

Many of our new activities and expansion plans require regulatory approvals, and failure to obtain them may restrict our growth.

We intend to complement and expand our business by pursuing strategic acquisitions of financial institutions and other complementary businesses. Generally, we must receive federal regulatory approval before we can acquire an FDIC-insured depository institution or related business. In determining whether to approve a proposed acquisition, federal banking regulators will consider, among other factors, the effect of the acquisition on competition, our financial condition, our future prospects, and the impact of the proposal on U.S. financial stability. The regulators also review current and projected capital ratios and levels, the competence, experience and integrity of management and its record of compliance with laws and regulations, the convenience and needs of the communities to be served (including the acquiring institution’s record of compliance under the Community Reinvestment Act, or the CRA) and the effectiveness of the acquiring institution in combating money laundering activities. Such regulatory approvals may not be granted on terms that are acceptable to us, or at all. We may also be required to sell banking locations as a condition to receiving regulatory approval, which condition may not be acceptable to us or, if acceptable to us, may reduce the benefit of any acquisition.

In addition to the acquisition of existing financial institutions, as opportunities arise, we plan to continue de novo branching as a part of our expansion strategy. De novo branching and acquisitions carry with them numerous risks, including the inability to obtain all required regulatory approvals. The failure to obtain these regulatory approvals for potential future strategic acquisitions and de novo banking locations could impact our business plans and restrict our growth.

Financial institutions, such as the Bank, face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.

The Bank Secrecy Act, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, or the USA PATRIOT Act, and other laws and regulations require financial institutions, among other duties, to institute and maintain an effective anti-money laundering program and file suspicious activity and currency transaction reports as appropriate. The Financial Crimes Enforcement Network, established by the U.S. Department of the Treasury, or the Treasury Department, to administer the Bank Secrecy Act, is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration and the Internal Revenue Service. There is also increased scrutiny of compliance with the sanctions programs and rules administered and enforced by the Treasury Department’s Office of Foreign Assets Control.

In order to comply with regulations, guidelines and examination procedures in this area, we have dedicated significant resources to our anti-money laundering program. If our policies, procedures and systems are deemed deficient, we

could be subject to liability, including fines and regulatory actions such as restrictions on our ability to

34

pay dividends and the inability to obtain regulatory approvals to proceed with certain aspects of our business plans, including acquisitions and de novo branching.

We are subject to numerous laws designed to protect consumers, including the Community Reinvestment Act and fair lending laws, and failure to comply with these laws could lead to a wide variety of sanctions.

The CRA, the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations impose nondiscriminatory lending requirements on financial institutions. The Consumer Financial Protection Bureau, or CFPB, the U.S. Department of Justice and other federal agencies are responsible for enforcing these laws and regulations. The CFPB was created under the Dodd-Frank Act to centralize responsibility for consumer financial protection with broad rulemaking authority to administer and carry out the purposes and objectives of federal consumer financial laws with respect to all financial institutions that offer financial products and services to consumers. The CFPB is also authorized to prescribe rules applicable to any covered person or service provider, identifying and prohibiting acts or practices that are “unfair, deceptive, or abusive” in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service. The ongoing broad rulemaking powers of the CFPB have potential to have a significant impact on the operations of financial institutions offering consumer financial products or services. The CFPB has indicated that it may propose new rules on overdrafts and other consumer financial products or services, which could have an adverse effect on our business, financial condition and results of operations if any such rules limit our ability to provide such financial products or services.

A successful regulatory challenge to an institution’s performance under the CRA, fair lending or consumer lending laws and regulations could result in a wide variety of sanctions, including damages and civil money penalties, injunctive relief, restrictions on mergers and acquisitions activity, restrictions on expansion, and restrictions on entering new business lines. Private parties may also have the ability to challenge an institution’s performance under fair lending laws in private class action litigation. Such actions could have an adverse effect on our business, financial condition and results of operations.

Increases in FDIC insurance premiums could adversely affect our earnings and results of operations.

We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. As a result of economic conditions and the enactment of the Dodd-Frank Act, the FDIC has in recent years increased deposit insurance assessment rates, which in turn raised deposit premiums for many insured depository institutions. In 2010, the FDIC increased the Deposit Insurance Fund’s target reserve ratio to 2.0% of insured deposits following the Dodd-Frank Act’s elimination of the 1.5% cap on the insurance fund’s reserve ratio, and the FDIC as put in place a restoration plan to restore the Deposit Insurance Fund to its 1.35% minimum reserve ratio managed by the Dodd-Frank Act by September 30, 2020. If recent increases in premiums are insufficient for the Deposit Insurance Fund to meet its funding requirements, further special assessments or increases in deposit insurance premiums may be required. Further, if there are additional financial institution failures that affect the Deposit Insurance Fund, we may be required to pay higher FDIC premiums. Our FDIC insurance related costs were \$625,000 for the year ended December 31, 2018, compared to \$671,000 for the year ended December 31, 2017. Any future additional assessments, increases or required prepayments in FDIC insurance premiums could adversely affect our earnings and results of operations.

The Federal Reserve may require us to commit capital resources to support the Bank.

The Federal Reserve requires a bank holding company to act as a source of financial and managerial strength to its subsidiary banks and to commit resources to support its subsidiary banks. Under the “source of strength” doctrine that was codified by the Dodd-Frank Act, the Federal Reserve may require a bank holding company to make capital injections into a troubled subsidiary bank at times when the bank holding company may not be inclined to do so and may charge the bank holding company with engaging in unsafe and unsound practices for failure to commit resources to such a subsidiary bank. Accordingly, we could be required to provide financial assistance to the Bank if it experiences financial distress.

A capital injection may be required at a time when our resources are limited, and we may be required to borrow the funds or raise capital to make the required capital injection. Any loan by a bank holding company to its subsidiary bank is subordinate in right with payment to deposits and certain other indebtedness of such subsidiary bank. In the event of a bank holding company’s bankruptcy, the bankruptcy trustee will assume any commitment by the holding

company to a federal bank regulatory agency to maintain the capital of a subsidiary bank. Moreover,

35

bankruptcy law provides that claims based on any such commitment will be entitled to a priority of payment over the claims of the holding company's general unsecured creditors, including the holders of any note obligations. Thus, any borrowing by a bank holding company for the purpose of making a capital injection to a subsidiary bank often becomes more difficult and expensive relative to other corporate borrowings.

We could be adversely affected by the soundness of other financial institutions.

Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. We have exposure to many different industries and counterparties, and routinely execute transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks and other institutional clients. Many of these transactions expose us to credit risk in the event of a default by a counterparty or client. In addition, our credit risk may be exacerbated when our collateral cannot be foreclosed upon or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due. Any such losses could adversely affect our business, financial condition and results of operations.

Monetary policies and regulations of the Federal Reserve could adversely affect our business, financial condition and results of operations.

In addition to being affected by general economic conditions, our earnings and growth are affected by the policies of the Federal Reserve. An important function of the Federal Reserve is to regulate the U.S. money supply and credit conditions. Among the instruments used by the Federal Reserve to implement these objectives are open market purchases and sales of securities by the Federal Reserve, adjustments of both the discount rate and the federal funds rate and changes in reserve requirements against bank deposits. These instruments are used in varying combinations to influence overall economic growth and the distribution of credit, bank loans, investments and deposits. Their use also affects interest rates charged on loans or paid on deposits.

The monetary policies and regulations of the Federal Reserve have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. Although we cannot determine the effects of such policies on us at this time, such policies could adversely affect our business, financial condition and results of operations.

We are subject to commercial real estate lending guidance issued by the federal banking regulators that impacts our operations and capital requirements.

The federal banking regulators have issued guidance regarding concentrations in commercial real estate lending directed at institutions that have particularly high concentrations of commercial real estate loans within their lending portfolios. This guidance suggests that institutions whose commercial real estate loans exceed certain percentages of capital should implement heightened risk management practices appropriate to their concentration risk and may be required to maintain higher capital ratios than institutions with lower concentrations in commercial real estate lending. Based on our commercial real estate concentration as of December 31, 2018, we believe that we are operating within the guidelines. However, increases in our commercial real estate lending, particularly as we expand into metropolitan markets and make more of these loans, could subject us to additional supervisory analysis. We cannot guarantee that any risk management practices we implement will be effective to prevent losses relating to our commercial real estate portfolio. Management has implemented controls to monitor our commercial real estate lending concentrations, but we cannot predict the extent to which this guidance will impact our operations or capital requirements.

Risks Related to an Investment in Our Common Stock

The market price of our common stock may be subject to substantial fluctuations, which may make it difficult for you to sell your shares at the volume, prices and times desired.

The market price of our common stock may be highly volatile, which may make it difficult for you to resell your shares at the volume, prices and times desired. There are many factors that may affect the market price and trading volume of our common stock, including, without limitation:

- actual or anticipated fluctuations in our operating results, financial condition or asset quality;
- changes in economic or business conditions;

the effects of, and changes in, trade, monetary and fiscal policies, including the interest rate policies of the Federal Reserve;

publication of research reports about us, our competitors, or the financial services industry generally, or changes in, or failure to meet, securities analysts' estimates of our financial and operating performance, or lack of research reports by industry analysts or ceasing of coverage;

operating and stock price performance of companies that investors deemed comparable to us;

additional or anticipated sales of our common stock or other securities by us or our existing shareholders;

additions or departures of key personnel;

- perceptions in the marketplace regarding our competitors or us, including the perception that investment in Texas is unattractive or less attractive during periods of low oil prices;

significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving our competitors or us;

other economic, competitive, governmental, regulatory and technological factors affecting our operations, pricing, products and services; and

other news, announcements or disclosures (whether by us or others) related to us, our competitors, our primary markets or the financial services industry.

The stock market and, in particular, the market for financial institution stocks have experienced substantial fluctuations in recent years, which in many cases have been unrelated to the operating performance and prospects of particular companies. In addition, significant fluctuations in the trading volume in our common stock may cause significant price variations to occur. Increased market volatility may materially and adversely affect the market price of our common stock, which could make it difficult to sell your shares at the volume, prices and times desired. The market price of our common stock could decline significantly due to actual or anticipated issuances or sales of our common stock in the future.

We may issue shares of our common stock or other securities from time to time as consideration for future acquisitions and investments and pursuant to compensation and incentive plans. If any such acquisition or investment is significant, the number of shares of our common stock, or the number or aggregate principal amount, as the case may be, of other securities that we may issue may in turn be substantial. We may also grant registration rights covering those shares of our common stock or other securities in connection with any such acquisitions and investments.

We cannot predict the size of future issuances of our common stock or the effect, if any, that future issuances and sales of our common stock will have on the market price of our common stock. Sales of substantial amounts of our common stock (including shares of our common stock issued in connection with an acquisition or under a compensation or incentive plan), or the perception that such sales could occur, may adversely affect prevailing market prices for our common stock and could impair our ability to raise capital through future sales of our securities. Securities analysts may not initiate or continue coverage on us.

The trading market for our common stock depends, in part, on the research and reports that securities analysts publish about us and our business. We do not have any control over these securities analysts, and they may not cover us. If one or more of these analysts cease to cover us or fail to publish regular reports on us, we could lose visibility in the financial markets, which could cause the price or trading volume of our common stock to decline. If we are covered by securities analysts and are the subject of an unfavorable report, the price of our common stock may decline.

Our management and board of directors have significant control over our business.

As of December 31, 2018, our Company only directors and executive officers beneficially owned an aggregate of 2,564,750 shares, or approximately 21.5%, of our issued and outstanding shares of common stock, including 299,679 shares that are held by our KSOP and allocated to the accounts of our named executive officers. As of December 31, 2018, our KSOP owned an aggregate of 1,333,541 shares, or approximately 11.3% of our issued and outstanding shares. A committee consisting of four independent directors of the Company, which we refer to herein as the KSOP Committee, currently serves as trustee of the KSOP. Each KSOP participant will have the right to vote the shares allocated to such participant's account on all matters requiring a vote of our shareholders, but the KSOP committee, as trustee of the KSOP, retains sole voting power over all shares held by the KSOP that are not allocated to participants' accounts and all shares for which they have received no voting instructions from the participant. As of December 31,

2018, there were no shares owned by our KSOP that were unallocated to participants' accounts.

37

As a result of their significant control over our business, our management and board of directors may be able to significantly affect the outcome of the election of directors and the potential outcome of other matters submitted to a vote of our shareholders, such as mergers, the sale of substantially all of our assets and other extraordinary corporate matters. The interests of these insiders could conflict with the interests of our other shareholders, including you. The holders of our existing debt obligations, as well as debt obligations that may be outstanding in the future, will have priority over our common stock with respect to payment in the event of liquidation, dissolution or winding up and with respect to the payment of interest.

In the event of any liquidation, dissolution or winding up of the Company, our common stock would rank below all claims of debt holders against us. As of December 31, 2018, we had a senior, unsecured line of credit with an available balance of \$25.0 million, but no amounts advanced, we had \$2.5 million of subordinated debt obligations and approximately \$10.3 million of junior subordinated debentures issued to statutory trusts that, in turn, issued \$10.0 million of trust preferred securities. Payments of the principal and interest on the trust preferred securities are conditionally guaranteed by us. Our debt obligations are senior to our shares of common stock. As a result, we must make payments on our debt obligations before any dividends can be paid on our common stock. In the event of our bankruptcy, dissolution or liquidation, the holders of our debt obligations must be satisfied before any distributions can be made to the holders of our common stock. We have the right to defer distributions on our junior subordinated debentures (and the related trust preferred securities) for up to five years, during which time no dividends may be paid to holders of our common stock. To the extent that we issue additional debt obligations or junior subordinated debentures, the additional debt obligations or additional junior subordinated debentures will be of equal rank with, or senior to, our existing debt obligations and senior to our shares of common stock.

We may issue shares of preferred stock in the future, which could make it difficult for another company to acquire us or could otherwise adversely affect holders of our common stock, which could depress the price of our common stock. Our certificate of formation authorizes us to issue up to 15,000,000 shares of one or more series of preferred stock. Our board of directors has the authority to determine the preferences, limitations and relative rights of shares of preferred stock and to fix the number of shares constituting any series and the designation of such series, without any further vote or action by our shareholders. Our preferred stock could be issued with voting, liquidation, dividend and other rights superior to the rights of our common stock. The potential issuance of preferred stock may delay or prevent a change in control of us, discouraging bids for our common stock at a premium over the market price, and materially adversely affect the market price and the voting and other rights of the holders of our common stock.

We are an emerging growth company, and the reduced regulatory and reporting requirements applicable to emerging growth companies may make our common stock less attractive to investors.

We are an emerging growth company, as defined in the JOBS Act. For as long as we continue to be an emerging growth company we may take advantage of reduced regulatory and reporting requirements that are otherwise generally applicable to public companies. These include, without limitation, not being required to comply with the auditor attestation requirements of Section 404(b) of the Sarbanes-Oxley Act, reduced financial reporting requirements, reduced disclosure obligations regarding executive compensation, and exemptions from the requirements of holding non-binding advisory votes on executive compensation and golden parachute payments. The JOBS Act also permits an emerging growth company such as us to take advantage of an extended transition period to comply with new or revised accounting standards applicable to public companies. However, we have irrevocably “opted out” of this provision, and we will comply with new or revised accounting standards to the same extent that compliance is required for non-emerging growth companies.

We may take advantage of these provisions for up to five years, unless we earlier cease to be an emerging growth company, which would occur if our annual gross revenues exceed \$1.0 billion, if we issue more than \$1.0 billion in non-convertible debt in a three-year period or if the market value of our common stock held by non-affiliates exceeds \$700.0 million as of any June 30, in which case we would no longer be an emerging growth company as of the following December 31. Investors may find our common stock less attractive because we intend to rely on certain of these exemptions, which may result in a less active trading market and increased volatility in our stock price.

We are dependent upon the Bank for cash flow, and the Bank’s ability to make cash distributions is restricted.

Our primary tangible asset is Guaranty Bank & Trust. As such, we depend upon the Bank for cash distributions (through dividends on the Bank's common stock) that we use to pay our operating expenses, satisfy our obligations (including our subordinated debentures and our other debt obligations) and to pay dividends on our common stock. Federal statutes, regulations and policies restrict the Bank's ability to make cash distributions to us. These statutes and regulations require, among other things, that the Bank maintain certain levels of capital in order to pay a dividend. Further, the OCC has the ability to restrict the Bank's payment of dividends by supervisory action. If the Bank is unable to pay dividends to us, we will not be able to satisfy our obligations or pay dividends on our common stock. Our dividend policy may change without notice, and our future ability to pay dividends is subject to restrictions. We anticipate that dividends will be declared and paid in the month following the end of each calendar quarter, and we anticipate paying a quarterly dividend on our common stock in an amount equal to approximately 25.0% to 30.0% of our net income for the immediately preceding quarter. However, holders of our common stock are entitled to receive only such cash dividends as our board of directors may declare out of funds legally available for such payments. Any declaration and payment of dividends on common stock will depend upon our earnings and financial condition, liquidity and capital requirements, the general economic and regulatory climate, our ability to service any equity or debt obligations senior to the common stock and other factors deemed relevant by our board of directors. Furthermore, consistent with our strategic plans, growth initiatives, capital availability, projected liquidity needs and other factors, we have made, and will continue to make, capital management decisions and policies that could adversely affect the amount of dividends, if any, paid to our common shareholders. The Federal Reserve has indicated that bank holding companies should carefully review their dividend policy in relation to the organization's overall asset quality, current and prospective earnings and level, composition and quality of capital. The guidance provides that we inform and consult with the Federal Reserve prior to declaring and paying a dividend that exceeds earnings for the period for which the dividend is being paid or that could result in an adverse change to our capital structure, including interest on the subordinated debentures underlying our trust preferred securities and our other debt obligations. If required payments on our outstanding junior subordinated debentures, held by our unconsolidated subsidiary trusts, or our other debt obligations, are not made or are deferred, or dividends on any preferred stock we may issue are not paid, we will be prohibited from paying dividends on our common stock. Our corporate organizational documents and provisions of federal and state law to which we are subject contain certain provisions that could have an anti-takeover effect and may delay, make more difficult or prevent an attempted acquisition that you may favor or an attempted replacement of our board of directors or management. Our certificate of formation and our bylaws (each as amended and restated) may have an anti-takeover effect and may delay, discourage or prevent an attempted acquisition or change of control or a replacement of our board of directors or management. Our governing documents include provisions that:

- empower our board of directors, without shareholder approval, to issue our preferred stock, the terms of which, including voting power, are to be set by our board of directors;
- divide our board of directors into three classes serving staggered three-year terms;
- provide that directors may only be removed from office for cause and only upon a majority shareholder vote;
- eliminate cumulative voting in elections of directors;
- permit our board of directors to alter, amend or repeal our amended and restated bylaws or to adopt new bylaws;
- require the request of holders of at least 50.0% of the outstanding shares of our capital stock entitled to vote at a meeting to call a special shareholders' meeting;
- prohibit shareholder action by less than unanimous written consent, thereby requiring virtually all actions to be taken at a meeting of the shareholders;
- require shareholders that wish to bring business before annual or special meetings of shareholders, or to nominate candidates for election as directors at our annual meeting of shareholders, to provide timely notice of their intent in writing; and
- enable our board of directors to increase, between annual meetings, the number of persons serving as directors and to fill the vacancies created as a result of the increase by a majority vote of the directors present at a meeting of directors.

In addition, certain provisions of Texas law, including a provision which restricts certain business combinations between a Texas corporation and certain affiliated shareholders, may delay, discourage or prevent an attempted acquisition or change in control. Furthermore, banking laws impose notice, approval, and ongoing regulatory requirements on any shareholder or other party that seeks to acquire direct or indirect “control” of an FDIC-insured depository institution or its holding company. These laws include the Bank Holding Company Act of 1956, as amended, or the BHC Act, and the Change in Bank Control Act, or the CBCA. These laws could delay or prevent an acquisition.

Furthermore, our amended and restated certificate of formation provides that the state courts located in Titus County, Texas, the county in which our headquarters in Mount Pleasant lie, will be the exclusive forum for: (a) any actual or purported derivative action or proceeding brought on our behalf, (b) any action asserting a claim of breach of fiduciary duty by any of our directors or officers, (c) any action asserting a claim against us or our directors or officers arising pursuant to the TBOC, our certificate of formation, or our bylaws; or (d) any action asserting a claim against us or our officers or directors that is governed by the internal affairs doctrine. By becoming a shareholder of our Company, you will be deemed to have notice of and have consented to the provisions of our amended and restated certificate of formation related to choice of forum. The choice of forum provision in our amended and restated certificate of formation may limit our shareholders’ ability to obtain a favorable judicial forum for disputes with us. Alternatively, if a court were to find the choice of forum provision contained in our amended and restated certificate of formation to be inapplicable or unenforceable in an action, we may incur additional costs associated with resolving such action in other jurisdictions, which could adversely affect our business, operating results, and financial condition.

An investment in our common stock is not an insured deposit and is subject to risk of loss.

Any shares of our common stock you purchase will not be savings accounts, deposits or other obligations of any of our bank or non-bank subsidiaries and will not be insured or guaranteed by the FDIC or any other government agency. Your investment will be subject to investment risk, and you must be capable of affording the loss of your entire investment.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Bank currently operates 30 banking locations, all of which are located in Texas. Our principal executive office is located at 16475 Dallas Parkway, Suite 600, Addison, Texas 75001. The Bank currently operates banking locations in the following Texas locations: Austin, Bogata, Bryan, College Station (two locations), Commerce, Conroe, Dallas (two locations), Denton (two locations), Fort Worth, Hallsville, Houston (three locations), Longview, Mount Pleasant (two locations), Mount Vernon, New Boston, Paris (two locations), Pittsburg, Rockwall, Royse City, Sulphur Springs, and Texarkana (three locations).

As of December 31, 2018, we owned 21 of our branch locations, had one location in which we owned the building and had a long-term land lease on the real property associated with the branch, and leased the remaining eight locations. The terms of our leases generally range from one to 15 years and give us the option to renew for subsequent terms of equal duration or otherwise extend the lease term subject to price adjustment based on market conditions at the time of renewal. We believe that the seven leases to which we are subject are generally on terms consistent with prevailing market terms, and none of the leases are with our directors, officers, beneficial owners of more than 5% of our voting securities or any affiliates of the foregoing. We believe that our facilities are in good condition and are adequate to meet our operating needs for the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

The Company is from time to time subject to claims and litigation arising in the ordinary course of business. These claims and litigation may include, among other things, allegations of violation of banking and other applicable regulations, competition law, labor laws and consumer protection laws, as well as claims or litigation relating to intellectual property, securities, breach of contract and tort. The Company intends to defend itself vigorously against any pending or future claims and litigation.

At this time, in the opinion of management, the likelihood is remote that the impact of such proceedings, either individually or in the aggregate, would have a material adverse effect on the Company combined results of operations,

financial condition or cash flows. However, one or more unfavorable outcomes in any claim or litigation against the Company could have a material adverse effect for the period in which they are resolved. In addition, regardless of their merits or their ultimate outcomes, such matters are costly, divert management's attention and may materially adversely affect the Company's reputation, even if resolved in our favor.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information for Common Stock

Shares of our common stock are traded on the NASDAQ Global Select Market under the symbol "GNTY." Our shares have been traded on the NASDAQ Global Select Market since May 9, 2017. Prior to that date, there was no public trading market for our common stock. The following table presents the range of high and low sales price per share reported on the NASDAQ Global Select Market for the period indicated.

	2018		2017	
	High	Low	High	Low
First Quarter	\$35.55	\$30.23	NA	NA
Second Quarter	35.56	31.95	36.38	29.00
Third Quarter	33.67	29.64	33.16	28.27
Fourth Quarter	31.55	28.83	31.70	28.00

Holders of Record

As of March 8, 2019, there were 405 holders of record of our common stock.

Dividend Policy

See "Item 8. Financial Statements and Supplementary Data—Quarterly Results of Operations" for the frequency and amount of cash dividends paid by us. Also, see "Item 1. Business—Regulation and Supervision—Guaranty Bancshares, Inc.—Regulatory Restrictions on Dividends" for restrictions on our present or future ability to pay dividends, particularly those restrictions arising under federal and state banking laws.

Unregistered Sales of Equity Securities

None.

Equity Compensation Plan Information

See "Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters."

Stock Performance Graph

The following table and graph compares the cumulative total shareholder return on our common stock to the cumulative total return of the S&P 500 Index and the SNL Bank Index for banks with \$1.0 billion to \$5.0 billion in total assets for the period beginning on May 9, 2017, the first day of trading of our common stock on the NASDAQ Global Select Market through December 31, 2018. The following assumes \$100 invested on May 9, 2017 in our common stock at our initial public offering price of \$27.00 per share, otherwise reflects our stock and the S&P 500 and SNL Bank \$1.0 to \$5.0 Billion Index values as of close of trading, and assumes the reinvestment of dividends, if any. The historical stock price performance for our common stock shown on the graph below is not necessarily indicative of future stock performance.

	May 9, 2017	June 30, 2017	September 30, 2017	December 31, 2017	March 31, 2018	June 30, 2018	September 30, 2018	December 31, 2018
Guaranty Bancshares, Inc.	\$100.00	\$118.81	\$119.44	\$114.98	\$125.48	\$124.60	\$114.90	\$114.01
S&P 500 Index	100.00	101.46	106.00	113.05	112.19	116.04	124.99	108.09
SNL Bank \$1B - \$5B Index	100.00	100.75	107.52	107.19	109.23	116.43	112.02	93.91

Source: S&P Global Market Intelligence

Stock Repurchases

On June 13, 2018, our board of directors approved a common stock repurchase plan that will remain in effect for a period of 24-months, unless shortened or extended by the board of directors. The board authorized the purchase of up to 500,000 shares, or approximately 4.2% of our outstanding common shares at that time. The repurchase plan permits shares to be acquired from time to time in the open market or negotiated transactions at prices management considers to be attractive and in the best interest of both Guaranty and its shareholders, subject to compliance with applicable laws and regulations, general market and economic conditions, the financial and regulatory condition of Guaranty, liquidity and other factors. The following are shares repurchased during the periods indicated:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plan
September 1 - 30, 2018	300	\$ 30.00	300	499,700
October 1 - 31, 2018	62,935	29.84	62,935	436,765
November 1 - 30, 2018	37,036	29.93	37,036	399,729
December 1 - 31, 2018	43,005	29.56	43,005	356,724
Total	143,276		143,276	

ITEM 6. SELECTED HISTORICAL CONSOLIDATED FINANCIAL INFORMATION

The following tables set forth certain of our summary historical consolidated financial information for each of the periods indicated. The historical information as of and for the years ended December 31, 2018 and 2017 has been derived from our audited consolidated financial statements included elsewhere in this Form 10-K, and the selected historical consolidated financial information as of and for the years ended December 31, 2016, 2015 and 2014 has been derived from our audited consolidated financial statements not appearing in this Form 10-K. The historical results set forth below are not necessarily indicative of our future performance.

You should read the following together with the sections entitled “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and our audited consolidated financial statements and the related notes included elsewhere in this Form 10-K.

(Dollars in Thousands, except Per Share Amounts)

	As of December 31,				
	2018	2017	2016	2015	2014
Selected Period End Balance Sheet Data:					
Total assets	\$2,266,970	\$1,962,624	\$1,828,336	\$1,682,640	\$1,334,068
Cash and cash equivalents	71,510	91,428	127,543	111,379	105,662
Securities available for sale	232,975	232,372	156,925	272,944	227,022
Securities held to maturity	163,164	174,684	189,371	125,031	131,068
Loans held for sale	1,795	1,896	2,563	3,867	3,915
Loans held for investment	1,659,535	1,359,544	1,243,925	1,067,377	786,519
Allowance for loan losses	14,651	12,859	11,484	9,263	7,721
Goodwill	32,160	18,742	18,742	18,601	6,116
Core deposit intangibles, net	4,706	2,724	3,308	3,846	2,881
Noninterest-bearing deposits	489,789	410,009	358,752	325,556	250,242
Interest-bearing deposits	1,381,691	1,266,311	1,218,039	1,140,641	826,550
Total deposits	1,871,480	1,676,320	1,576,791	1,466,197	1,076,792
Federal Home Loan Bank advances	115,136	45,153	55,170	21,342	111,539
Subordinated debentures	12,810	13,810	19,310	21,310	9,155
Other debt	—	—	18,286	18,000	11,000
KSOP-owned shares	—	—	31,661	35,384	36,300
Total shareholders’ equity less KSOP-owned shares	244,583	207,345	110,253	102,352	75,989
Pro forma total shareholders’ equity ⁽¹⁾	244,583	207,345	141,914	137,736	112,289

	As of and for the Years Ended December 31,						
	2018	2017	2016	2015	2014		
Selected Income Statement Data:							
Net interest income	\$68,916	\$59,630	\$53,840	\$47,759	\$39,123		
Provision for loan losses	2,250	2,850	3,640	2,175	1,322		
Net interest income after provision for loan losses	66,666	56,780	50,200	45,584	37,801		
Noninterest income	15,303	14,279	13,016	11,483	10,792		
Noninterest expense	56,774	48,382	46,380	42,594	34,854		
Net realized (loss) gain on sale of securities	(50)	167	82	77	(212)		
Income before income tax	25,195	22,677	16,836	14,473	13,739		
Income tax expense	4,599	8,238	4,715	4,362	4,023		
Net earnings	20,596	14,439	12,121	10,111	9,716		
Dividends paid to common shareholders ⁽²⁾	7,031	5,562	4,615	4,526	11,863		
			As of and for the Years Ended December 31,				
			2018	2017	2016	2015	2014
Per Share Data:							
Earnings per common share, basic			\$1.78	\$ 1.41	\$ 1.35	\$ 1.15	\$ 1.25
Earnings per common share, diluted			1.77	1.40	1.35	1.15	1.25
Book value per common share ⁽³⁾			20.68	18.75	16.22	15.47	14.01
Tangible book value per common share ⁽³⁾⁽⁴⁾			17.56	16.81	13.70	12.95	12.89
Weighted average common shares outstanding, basic, in thousands			11,563,000	10,231,000	8,968,000	8,796,000	7,771,000
Weighted average common shares outstanding, diluted, in thousands			11,654,000	10,113,000	8,976,000	8,802,000	7,771,000

	As of December 31,					
	2018	2017	2016	2015	2014	
Summary Performance Ratios:						
Return on average assets ⁽⁵⁾⁽⁶⁾	0.97	% 0.76	% 0.68	% 0.65	% 0.76	%
Return on average equity ⁽³⁾⁽⁵⁾⁽⁶⁾	9.03	7.78	8.34	7.44	8.69	
Net interest margin ⁽⁷⁾	3.49	3.38	3.27	3.33	3.33	
Efficiency ratio ⁽⁸⁾	67.37	65.61	69.46	71.99	69.53	
Loans to deposits ratio ⁽⁹⁾	88.68	81.10	78.89	72.80	73.04	
Noninterest income to average assets ⁽⁵⁾	0.72	0.75	0.73	0.74	0.85	
Noninterest expense to average assets ⁽⁵⁾	2.67	2.55	2.61	2.75	2.74	
Summary Credit Quality Ratios:						
Nonperforming assets to total assets	0.34	% 0.44	% 0.53	% 0.25	% 0.37	%
Nonperforming loans to total loans ⁽⁹⁾	0.35	0.29	0.35	0.23	0.52	
Allowance for loan losses to nonperforming loans	248.70	321.15	260.47	381.04	189.38	
Allowance for loan losses to total loans ⁽⁹⁾	0.88	0.95	0.92	0.87	0.98	
Net charge-offs to average loans outstanding ⁽¹⁰⁾	0.03	0.11	0.12	0.06	0.09	
Capital Ratios:						
Total shareholders' equity to total assets	10.79	% 10.56	% 7.76	% 8.19	% 8.42	%
Tangible common equity to tangible assets ⁽¹¹⁾	9.31	9.58	6.64	6.94	7.80	
Common equity tier 1 capital (CET1) to risk-weighted assets	11.88	12.61	9.28	10.43	n/a	
Tier 1 capital to average assets ⁽⁵⁾	10.16	10.53	7.71	8.33	9.05	
Tier 1 capital to risk-weighted assets	12.44	13.29	10.03	11.30	13.65	
Total capital to risk-weighted assets	13.25	14.13	10.86	12.08	14.57	

In accordance with provisions of the Internal Revenue Code applicable to private companies, prior to our listing on the NASDAQ Global Select Market, the terms of our KSOP provided that KSOP participants had the right, for a specified period of time, to require us to repurchase shares of our common stock that are distributed to them by the (1)KSOP. As a result, for the periods prior to our listing on the NASDAQ Global Select Market, the shares of common stock held by the KSOP are deducted from shareholders' equity in our consolidated balance sheet. This repurchase right terminated upon the listing of our common stock on the NASDAQ Global Select Market on May 9, 2017.

We terminated our election to be taxed as a Subchapter S corporation under the provisions of Section 1361-1379 of the Internal Revenue Code effective December 31, 2013. We paid a special dividend of \$1.00 per share, in addition (2)to a regular dividend of \$0.50 per share, during the year ended December 31, 2014, since all dividends we pay for the first 12 months following the termination of our Subchapter S election were not subject to federal income taxation.

(3) Book value per common share and tangible book value per common share calculations reflect the Company's pro forma total shareholders' equity.

We calculate tangible book value per common share as total shareholders' equity less goodwill, core deposit intangibles and other intangible assets, net of accumulated amortization at the end of the relevant period, divided by the outstanding number of shares of our common stock at the end of the relevant period. Tangible book value per common share is a financial measure that is not recognized by, or calculated in accordance with, U.S. generally (4)accepted accounting principles, or GAAP, and, as we calculate tangible book value per common share, the most directly comparable GAAP financial measure is total shareholders' equity per common share. See our reconciliation of non-GAAP financial measures to their most directly comparable GAAP financial measures under the caption "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Non-GAAP Financial Measures."

(5) We calculate our average assets and average equity for a period by dividing the period end balances of our total assets or total shareholders' equity, as the case may be, by the number of months in the period.

(6)

We have calculated our return on average assets and return on average equity for a period by dividing net earnings for that period by our average assets and average equity, as the case may be, for that period.

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

(8) The efficiency ratio was calculated by dividing total noninterest expenses by net interest income plus noninterest income, excluding securities losses or gains. Taxes are not part of this calculation.

(9) Excludes loans held for sale of \$1.8 million, \$1.9 million, \$2.6 million, \$3.9 million, and \$3.9 million for the years ended December 31, 2018, 2017, 2016, 2015 and 2014, respectively.

(10) Includes average outstanding balances of loans held for sale of \$1.7 million, \$1.7 million, \$3.0 million, \$4.4 million, and \$4.2 million for the years ended December 31, 2018, 2017, 2016, 2015 and 2014, respectively.

We calculate tangible common equity as total shareholders' equity less goodwill, core deposit intangibles and other intangible assets, net of accumulated amortization, and we calculate tangible assets as total assets less goodwill and core deposit intangibles and other intangible assets, net of accumulated amortization. Tangible common equity to tangible assets is a financial measure that is not recognized by or calculated in accordance with GAAP, or a non-GAAP financial measure, and, as we calculate tangible common equity to tangible assets, the most directly comparable GAAP financial measure is total shareholders' equity to total assets. See our reconciliation of non-GAAP

financial measures to their most directly comparable GAAP financial measures under the caption “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations—Non-GAAP Financial Measures.”

ITEM 7. 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 “Item 6. Selected Financial Data” and the Company’s audited consolidated financial statements and the accompanying notes included in “Item 8: Financial Statements and Supplementary Data.” This discussion and analysis contains forward-looking statements that are subject to certain risks and uncertainties and are based on certain assumptions that we believe are reasonable but may prove to be inaccurate. Certain risks, uncertainties and other factors, including those set forth under “Forward-Looking Statements,” “Risk Factors” and elsewhere in this Annual Report on Form 10-K, may cause actual results to differ materially from those projected results discussed in the forward-looking statements appearing in this discussion and analysis. We assume no obligation to update any of these forward-looking statements.

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements. These forward-looking statements reflect our current views with respect to, among other things, future events and our financial performance. These statements are often, but not always, made through the use of words or phrases such as “may,” “should,” “could,” “predict,” “potential,” “believe,” “will likely result,” “expect,” “continue,” “will,” “anticipate,” “seek,” “estimate,” “intend,” “plan,” “projection,” “would” and “could.” These forward-looking statements include both positive and negative versions of those words or other comparable words or phrases of a future or forward-looking nature. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about our industry, management’s beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. Accordingly, we caution you that any such forward-looking statements are not guarantees of future performance and are subject to risks, assumptions and uncertainties that are difficult to predict. Although we believe that the expectations reflected in these forward-looking statements are reasonable as of the date made, actual results may prove to be materially different from the results expressed or implied by the forward-looking statements.

There are or will be important factors that could cause our actual results to differ materially from those indicated in these forward-looking statements, including, but not limited to, the following:

- our ability to prudently manage our growth and execute our strategy;
- risks associated with our acquisition and de novo branching strategy;
- business and economic conditions generally and in the financial services industry, nationally and within our primary markets;
- deterioration of our asset quality;
- changes in the value of collateral securing our loans;
- changes in management personnel;
- liquidity risks associated with our business;
- interest rate risk associated with our business;
- our ability to maintain important deposit customer relationships and our reputation;
- operational risks associated with our business;
- volatility and direction of market interest rates;
- increased competition in the financial services industry, particularly from regional and national institutions;
- changes in the laws, rules, regulations, interpretations or policies relating to financial institution, accounting, tax, trade, monetary and fiscal matters;
- further government intervention in the U.S. financial system;
-

natural disasters and adverse weather, acts of terrorism, an outbreak of hostilities or other international or domestic calamities, and other matters beyond our control; and
• other factors that are discussed in "Item 1A. Risk Factors."

The foregoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included in this Annual Report on Form 10-K. If one or more events related to these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may differ materially from what we anticipate. Accordingly, you should not place undue reliance on any such forward-looking

statements. Any forward-looking statement speaks only as of the date on which it is made, and we do not undertake any obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise. New factors emerge from time to time, and it is not possible for us to predict which will arise. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

General

The following discussion and analysis presents our financial condition and results of operations on a consolidated basis. However, because we conduct all of our material business operations through Guaranty Bank & Trust, the discussion and analysis relates to activities primarily conducted by Guaranty Bank & Trust.

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.

Acquisitions

The comparability of our consolidated results of operations for the year ending December 31, 2018 to the year ended December 31, 2017 is affected by the acquisition of Westbound Bank on June 1, 2018. Therefore, the results of the acquired operations of Westbound Bank were included in our results of operations for a portion of 2018 but were not included in our results of operations for all of 2017 and 2016.

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 financial statements to those judgments and assumptions, are 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 originating 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. 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). The credit quality of loans in our commercial real estate related loan portfolio is impacted by delinquency status and debt service coverage generated by the borrowers' business 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 for some period of time, a process we refer 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.

49

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. At December 31, 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. 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 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.

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.

Performance Summary for the Years Ended December 31, 2018 and 2017

Net earnings were \$20.6 million for the year ended December 31, 2018, as compared to \$14.4 million for the year ended December 31, 2017. This performance resulted in basic earnings per share of \$1.78 for the year ended December 31, 2018 as compared to \$1.41 for the year ended December 31, 2017. The increase in net earnings over this period was primarily the result of the acquisition of Westbound Bank on June 1, 2018, the continued maturity of the de novo locations in both the Central Texas and Dallas/Fort Worth MSA markets and a decrease in income tax provision of \$3.6 million, or 44.2%. The increase in earnings per share over this period was due to the 42.6% increase in net earnings compared to a 13.0% increase in the weighted average shares outstanding, which included the issuance

of 899,816 shares in the Westbound acquisition offset by the repurchase of 143,276 shares of common stock during the third and fourth quarters of 2018.

Our return on average assets was 0.97% for the year ended December 31, 2018, as compared to 0.76% for the year ended December 31, 2017. Our return on average equity was 9.03% for the year ended December 31, 2018, as compared to 7.78% for the year ended December 31, 2017. The increase in our return on average assets was primarily due to an increase in net earnings of 42.6%, relative to a smaller increase of 12.1% for total average assets. The increase in the return on average equity was primarily due to an increase in net earnings of 42.6%, relative to a smaller increase in average shareholder's equity of 23.0%.

Our net interest margin was 3.49% for the year ended December 31, 2018 and 3.38% for the year ended December 31, 2017. Our net interest margin increased as a result of improvements in loan yields due to rising interest rates, compared to smaller increases in the interest rates paid on deposit accounts. Our efficiency ratio was 67.37% for the year ended December 31, 2018, as compared to 65.61% for the year ended December 31, 2017. The decline in our efficiency ratio for 2018 is largely attributable to one-time costs associated with our acquisition of Westbound Bank in June 2018. Non-interest expense increased by 17.3%, while applicable elements of income increased by only 14.3%, during 2018.

Our total assets increased \$304.3 million, or 15.5%, to \$2.27 billion for the year ended December 31, 2018, compared to \$1.96 billion for the year ended December 31, 2017. Total loans increased \$297.7 million, or 22.1%, to \$1.65 billion for the year ended December 31, 2018, compared to \$1.35 billion for the year ended December 31, 2017. The increase in our total assets and total loans is primarily the result of \$154.7 million of loans acquired from Westbound Bank, along with organic loan growth in 2018 of \$143.0 million. Total shareholders' equity increased \$37.2 million, or 18.0%, to \$244.6 million for the year ended December 31, 2018, compared to \$207.3 million for the year ended December 31, 2017. The increase in shareholders' equity was due primarily to the 42.6% increase in net earnings in 2018 and the issuance of additional common stock in connection with the acquisition of Westbound Bank.

Results of Operations for the Years Ended December 31, 2018, 2017 and 2016

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.

2018 vs. 2017. Net interest income for the year ended December 31, 2018 was \$68.9 million, compared to \$59.6 million for the same period in 2017, an increase of \$9.3 million, or 15.6%. The increase in net interest income was comprised of a \$16.7 million, or 23.2%, increase in interest income offset by a \$7.4 million, or 60.8%, increase in interest expense. The growth in interest income was primarily attributable to a \$241.5 million, or 18.8%, increase in average loans outstanding for the year ended December 31, 2018, compared to the same period in 2017, as well as a 31 basis point increase in the yield on average total loans. The increase in average loans outstanding was primarily due to the addition of \$154.7 million of loans with the acquisition of Westbound Bank in June 2018, as well as organic growth in all of our markets. The \$7.4 million increase in interest expense for the year ended December 31, 2018 was primarily related to an increase in rates paid on interest bearing deposits from an average rate of 0.92% in 2017 to 1.35% in 2018, along with an increase of \$83.6 million, or 6.7%, in average interest-bearing deposits over the same period in 2017. The majority of this increase is due to \$181.4 million of deposits acquired from Westbound, offset by a decrease in interest-bearing public funds deposit accounts during 2018 of approximately \$60.1 million. For the year ended December 31, 2018, net interest margin and net interest spread were 3.49% and 3.13%, respectively, compared to 3.38% and 3.14% for the same period in 2017, which reflects the increases in interest income discussed above relative to the increases in average interest-earning assets and interest expense, respectively.

2017 vs. 2016. Net interest income for the year ended December 31, 2017 was \$59.6 million compared to \$53.8 million for the same period in 2016, an increase of \$5.8 million, or 10.8%. The increase in net interest income was comprised of an \$7.1 million, or 10.9%, increase in interest income offset by a \$1.3 million, or 11.8%, increase in

interest expense. The growth in interest income was primarily attributable to a \$103.3 million, or 8.8%, increase in

51

average loans outstanding for the year ended December 31, 2017, compared to the same period 2016, partially offset by a four basis point increase in the yield on average 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 Central Texas and Dallas/Fort Worth MSA markets. The \$1.3 million increase in interest expense for the year ended December 31, 2017 was primarily related to a \$65.6 million, or 5.6%, increase in average interest-bearing deposits over the same period in 2016. The majority of this increase is due to organic growth, primarily in money market accounts, driven in part by favorable rates that were offered in our Central Texas and Dallas/Fort Worth MSA markets. For the year ended December 31, 2017, net interest margin and net interest spread were 3.38% and 3.14%, respectively, compared to 3.27% and 3.08% for the same period in 2016, which reflects the increases in interest income discussed above relative to the increases in average interest-earning assets and interest expense, respectively. 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 years ended December 31, 2018, 2017 and 2016, 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.

	For the Years Ended December 31,									
	2018			2017			2016			
	Average Outstanding Balance	Interest Earned/ Interest Paid	Average Yield/ Rate	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⁾	\$1,524,792	\$77,170	5.06 %	\$1,283,253	\$61,014	4.75 %	\$1,179,938	\$55,565	4.71 %	
Securities available for sale	236,799	5,927	2.50 %	223,095	5,081	2.28 %	198,372	3,723	1.88 %	
Securities held to maturity.	167,919	4,160	2.48 %	182,549	4,409	2.42 %	182,870	4,678	2.56 %	
Nonmarketable equity securities	9,625	432	4.49 %	7,134	465	6.52 %	8,547	271	3.17 %	
Interest-bearing deposits in other banks	35,521	769	2.16 %	70,692	813	1.15 %	78,232	471	0.60 %	
Total interest-earning assets	1,974,656	\$88,458	4.48 %	1,766,723	\$71,782	4.06 %	1,647,959	\$64,708	3.93 %	
Allowance for loan losses	(13,825)			(12,217)			(10,826)			
Noninterest-earnings assets	167,734			144,971			139,575			
Total assets	\$2,128,565			\$1,899,477			\$1,776,708			
Liabilities and Stockholders' Equity										
Interest-bearing liabilities:										
Interest-bearing deposits	\$1,324,744	\$16,941	1.28 %	\$1,241,115	\$10,604	0.85 %	\$1,175,520	\$9,050	0.77 %	

Edgar Filing: GUARANTY BANCSHARES INC /TX/ - Form 10-K

Advances from FHLB and fed funds purchased	94,338	1,865	1.98 %	46,268	472	1.02 %	62,961	299	0.47 %
Other debt	—	—	— %	6,711	301	4.49 %	13,198	586	4.44 %
Subordinated debentures	13,309	687	5.16 %	15,902	724	4.55 %	20,313	882	4.34 %
Securities sold under agreements to repurchase	12,796	49	0.38 %	13,306	51	0.38 %	13,011	51	0.39 %
Total interest-bearing liabilities	1,445,187	19,542	1.35 %	1,323,302	12,152	0.92 %	1,285,003	10,868	0.85 %
Noninterest-bearing liabilities:									
Noninterest-bearing deposits	446,560			384,049			340,240		
Accrued interest and other liabilities	8,754			6,648			6,080		
Total noninterest-bearing liabilities	455,314			390,697			346,320		
Shareholders' equity	228,064			185,478			145,385		
Total liabilities and shareholders' equity	\$2,128,565			\$1,899,477			\$1,776,708		
Net interest rate spread ⁽²⁾			3.13 %			3.14 %			3.08 %
Net interest income		\$68,916			\$59,630			\$53,840	
Net interest margin ⁽³⁾			3.49 %			3.38 %			3.27 %

(1) Includes average outstanding balances of loans held for sale of \$1.7 million, \$1.7 million and \$3.0 million for the years ended December 31, 2018, 2017 and 2016 respectively.

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

	For the Years Ended December 31, 2018 vs. 2017		For the Years Ended December 31, 2017 vs. 2016		Total Increase (Decrease)	
	Increase (Decrease) Due to Change in Volume	Total Increase (Decrease) Rate	Increase (Decrease) Due to Change in Volume	Total Increase (Decrease) Rate		
Interest-earning assets:						
Total loans	\$12,224	\$3,932	\$16,156	\$4,912	\$537	\$5,449
Securities available for sale	343	503	846	563	795	1,358
Securities held to maturity	(362)	113	(249)	(8)	(261)	(269)
Nonmarketable equity securities	112	(145)	(33)	(92)	286	194
Interest-earning deposits in other banks	(761)	717	(44)	(87)	429	342
Total increase in interest income	\$11,556	\$5,120	\$16,676	\$5,288	\$1,786	\$7,074
Interest-bearing liabilities:						
Interest-bearing deposits	\$1,069	\$5,268	\$6,337	\$560	\$994	\$1,554
Advances from FHLB and Fed funds Purchased	950	443	1,393	(170)	343	173
Other debt	—	(301)	(301)	(291)	6	(285)
Subordinated debentures	(134)	97	(37)	(201)	43	(158)
Securities sold under agreements to repurchase	(2)	—	(2)	1	(1)	—
Total (decrease) increase in interest expense	1,883	5,507	7,390	(101)	1,385	1,284
Increase (decrease) in net interest income	\$9,673	\$(387)	\$9,286	\$5,389	\$401	\$5,790

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. For a description of the factors taken into account by our management in determining the allowance for loan losses see “— Financial Condition—Allowance for Loan Losses.” The provision for loan losses for the year ended December 31, 2018 was \$2.3 million compared to \$2.9 million for the year ended December 31, 2017. As of December 31, 2018 and December 31, 2017, our allowance for loan and lease losses was \$14.7 million and \$12.9 million, respectively, which were comprised of general allowance reserves of \$14.2 million and \$12.7 million, respectively, with specific reserves allocated to cover classified and problem loans of \$493,000 and \$134,000, respectively. The decrease in provision expense was primarily due to lower net charge-offs during 2018 and loan growth at a slower rate during 2018 than during 2017. As of December 31, 2018, there was \$15.0 million in loan balances past due 30 or more days and \$5.9 million in loan balances for nonperforming (nonaccrual) loans, compared to \$9.3 million and \$4.0 million, respectively, for the year ended December 31, 2017. The increase in past due and non-accrual loans from the prior period is primarily the result of one loan relationship, consisting of three loans, with an outstanding book balance of \$3.2 million as of December 31, 2018; however, this relationship has a 75% SBA guarantee with the remainder of the balance reserved under an escrow holdback agreement made in conjunction with the Westbound Bank acquisition. Therefore, the nonaccrual and past due status of this relationship did not affect the

loan loss provision or reserve amounts during 2018 because no losses are expected to be incurred.

53

The provision for loan losses for the year ended December 31, 2017 was \$2.9 million compared to \$3.6 million for the year ended December 31, 2016. As of December 31, 2017 and December 31, 2016, our allowance for loan and lease losses was \$12.9 million and \$11.5 million, respectively, which were comprised of general allowance reserves were \$12.7 million and \$11.2 million, respectively, with specific reserves allocated to cover classified and problem loans of \$134,000 and \$253,000, respectively. The decrease in provision expense was primarily due to improved credit quality and loan growth at a slower rate during 2017 than during 2016. As of December 31, 2017, there was \$9.3 million in loan balances past due 30 days or more and \$4.0 million in loan balances for nonperforming (nonaccrual) loans, compared to \$11.7 million and \$4.4 million, respectively for the year ended December 31, 2016.

Net charge-offs for the year ended December 31, 2018 totaled \$458,000, or 0.03%, of total loans, compared to net charge-offs of \$1.5 million, or 0.11%, and net charge-offs of \$1.4 million, or 0.11%, for the same periods in 2017 and 2016, respectively. The decrease in net charge-offs during 2018 was primarily due to fewer charge-offs of commercial and industrial, consumer and 1-4 family mortgages during 2018, as well as a higher percentage of recoveries in 2018 for loans that were previously charged-off. The slight increase in net charge-offs for the year ended December 31, 2017, from the year ended December 31, 2016, resulted from a minor increase in the volume of smaller dollar consumer loan charge-offs compared to the prior year, but there were no individual charge-offs that were greater than \$500,000.

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.

For the year ended December 31, 2018, noninterest income totaled \$15.3 million, an increase of \$1.0 million, or 7.2%, compared to \$14.3 million for the year ended December 31, 2017. For the year ended December 31, 2017, noninterest income increased \$1.3 million, or 9.7%, from \$13.0 million for the year ended December 31, 2016. The following table presents, for the periods indicated, the major categories of noninterest income:

	For the Years Ended December 31,		Increase (Decrease)	For the Years Ended December 31,		Increase (Decrease)
	2018	2017		2017	2016	
	(Dollars in thousands)					
Noninterest income:						
Service charges on deposit accounts	\$3,600	\$3,746	\$ (146)	\$3,746	\$3,530	\$ 216
Merchant and debit card fees	3,642	3,119	523	3,119	2,741	378
Fiduciary income	1,587	1,463	124	1,463	1,405	58
Gain on sales of loans	2,308	1,981	327	1,981	1,718	263
Bank-owned life insurance income	570	461	109	461	453	8
(Loss) gain on sales of investment securities	(50)	167	(217)	167	82	85
Loan processing fee income	589	597	(8)	597	622	(25)
Other	3,057	2,745	312	2,745	2,465	280
Total noninterest income	\$15,303	\$14,279	\$ 1,024	\$14,279	\$13,016	\$ 1,263

Service Charges on Deposit Accounts. We earn fees from our customers for deposit-related services, and these fees constitute a significant and predictable component of our noninterest income. Service charges on deposit accounts were \$3.6 million for the year ended December 31, 2018, which decreased over the same period in 2017 by \$146,000, or 3.9%. The decrease was due primarily to lower insufficient fund income of approximately \$185,000, partially offset from smaller increases in account analysis and other service charges from the same period in 2017. The decrease in insufficient fund income 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. Service charges on deposit accounts were 3,746 for the year ended December 31, 2017, which increased over the same period in 2016 by \$216,000, or 6.1%. The increase was due in part to growth in deposit accounts of 6.3% during the period and in part due to our charging

services fees to the commercial account analysis deposit accounts that we acquired from DCB Financial and Texas Leadership Bank, which we did not do in 2016.

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 \$3.6 million and \$3.1 million for the years ended December 31, 2018 and 2017, respectively, an increase of \$523,000, or 16.8%. Debit card interchange income increased \$378,000, or 13.8%, from \$2.7 million in 2016. The increases in both years were primarily due to growth in the number of demand deposit accounts and increases in the volume of debit card usage. The acquisition of Westbound Bank on June 1, 2018 also impacted the growth in income during 2018.

Fiduciary Income. We have trust powers and provide fiduciary and custodial services through our trust and wealth management division. Fiduciary income was \$1.6 million and \$1.5 million for the years ended December 31, 2018 and 2017, respectively, increasing by \$124,000, or 8.5%. The revenue increase resulted primarily from 48 new accounts that were opened in 2018 that generated additional income. Furthermore, 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 assets based on the book value. Total managed assets held as of December 31, 2018 were \$289.8 million, of which \$151.7 million, or 52.3%, were in custody-only services. However, this market value at December 31, 2018 reflects the steep declines in the stock market in the fourth quarter of 2018 and is not reflective of the market values throughout the entire year. Total managed assets held as of December 31, 2017 were \$310.5 million, of which \$175.5 million, or 56.5%, were in custody-only services. Fiduciary income increased \$58,000, or 4.1%, from \$1.4 million in 2016, in part due to increases in fee schedules implemented during 2017 and in part due to market values of the managed assets.

Gain on Sales of Loans. We originate long-term fixed-rate mortgage loans for resale into the secondary market. Our mortgage originations sold were \$70.8 million for the year ended December 31, 2018, compared to \$64.8 million for the year ended December 31, 2017. For the year ended December 31, 2016, our mortgage originations sold were \$62.6 million. Gain on sales of loans was \$2.3 million for the year ended December 31, 2018, an increase of \$327,000, or 16.5%, compared to \$2.0 million for the same period in 2017, which reflects an increase in the number of loans sold and the amount of gain per loan sold. Gain on sales of loans increased by \$263,000, or 15.3%, from \$1.1 million in 2016 to \$1.7 million in 2017, which reflects an increase in the number of loans sold and the amount of gain per loan sold.

Bank-Owned Life Insurance. 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 \$109,000, or 23.6%, for the year ended December 31, 2018 compared to the same period in 2017, primarily due to an increase in tax equivalent yields on the policies from 3.8% in 2017 to 4.1% in 2018. Income for the year ending December 31, 2017 increased slightly by \$8,000, or 1.8%, from the year ending December 31, 2016. The increase in income was primarily due to the purchase of \$850,000 of additional bank owned life insurance in the fourth quarter of 2017, which was partially offset by a decrease in tax equivalent yields on these policies from 4.0% in 2016 to 3.8% in 2017.

(Loss) Gain on Sales of Investment Securities. We recorded a loss on sales of securities in the amount of \$50,000 during the year ended December 31, 2018 and gains on sales of securities in the amounts of \$167,000 and \$82,000 for the years ended December 31, 2017 and 2016, respectively. The loss incurred in 2018 is primarily attributable to a mortgage-backed agency security sold that had recorded an increase in pay-downs and therefore a corresponding yield reduction. The gains taken in 2017 and 2016 relate to securities sold that had higher yields in the current markets, but that management believed also had higher volatility risk in an increasing interest rate environment. Accordingly, we sold these securities and recorded gains on the sales in an effort to decrease our interest rate risk.

Loan Processing Fee Income. Revenue earned from collection of loan processing fees decreased \$8,000, or 1.34%, to \$589,000 for the year ended December 31, 2018 from \$597,000 for the year ended December 31, 2017. Loan processing fees decreased \$25,000, or 4.0%, for the year ended December 31, 2017, from \$622,000 for the year ended December 31, 2016. These slight decreases in loan processing fee income are attributable primarily to waiving of certain of these fees in our newer growth markets to facilitate loan growth during the periods.

Other. This category includes a variety of other income producing activities, including mortgage loan origination fees, wire transfer fees, check printing fees, loan administration fees, and other income. Other noninterest income increased \$312,000, or 11.4%, in 2018 compared to 2017 due primarily to a gain on the sale of our Atlanta

bank location of \$830,000 in December 2018, as well as increases in wire transfer volume and related fees and check printing fees. These increases were partially offset during 2018 by 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 and a loss on the sale of a former bank location in Longview, Texas of \$229,000. Other income increased \$280,000, or 11.4%, in 2017 compared to 2016 primarily due to increases in wire transfer volume and related fees, fees from in-house appraisal reviews that were outsourced in prior years and increased mortgage related income due to increased mortgage origination volume.

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 year ended December 31, 2018, noninterest expense totaled \$56.8 million, an increase of \$8.4 million, or 17.4%, compared to \$48.4 million for the same period in 2017. Noninterest expense increased \$2.0 million, or 4.3%, for the year ended December 31, 2017, compared to the same period in 2016. The following table presents, for the periods indicated, the major categories of noninterest expense:

	For the Years Ended			For the Years Ended		
	December 31,		Increase	December 31,		Increase
	2018	2017	2018 v. 2017	2017	2016	2017 v. 2016
	(Dollars in thousands)					
Employee compensation and benefits	\$32,122	\$27,078	\$ 5,044	\$ 27,078	\$ 25,611	\$ 1,467
Non-staff expenses:						
Occupancy expenses	8,398	7,400	998	7,400	6,870	530
Amortization	1,228	1,033	195	1,033	980	53
Software support fees	2,502	2,089	413	2,089	1,870	219
FDIC insurance assessment fees	625	671	(46)	671	1,200	(529)
Legal and professional fees	3,080	2,061	1,019	2,061	1,935	126
Advertising and promotions	1,410	1,193	217	1,193	1,015	178
Telecommunication expense	649	526	123	526	609	(83)
ATM and debit card expense	1,127	899	228	899	933	(34)
Director and committee fees	1,029	1,064	(35)	1,064	940	124
Other	4,604	4,368	236	4,368	4,417	(49)
Total noninterest expense	\$56,774	\$48,382	\$ 8,392	\$ 48,382	\$ 46,380	\$ 2,002

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 \$32.1 million for the year ended December 31, 2018, an increase of \$5.0 million, or 18.6%, compared to \$27.1 million for the same period in 2017. The increase was due primarily to an increase in the number of employees from 397 to 454, of which 28 new employees were related to the Westbound acquisition and 11 were from our two de novo locations in Austin and Fort Worth, Texas that were opened in the fourth quarter of 2017, and the remaining new employees were added to support operational growth and our SBA department. Salaries and employee benefits increased \$1.5 million, or 5.7%, for the year ended December 31, 2017, as compared to \$25.6 million for the same period in 2016, primarily due to an increase in the number of employees from 397 to 407, as well as increased health insurance expenses, benefit plan expenses and payroll taxes.

Occupancy Expenses. Occupancy expenses were \$8.4 million and \$7.4 million for the years ended December 31, 2018 and 2017, respectively. This category includes building, leasehold, furniture, fixtures and equipment depreciation totaling \$3.4 million and \$3.2 million for the years ended December 31, 2018 and 2017, respectively. The increase of \$998,000, or 13.5%, in occupancy expenses for 2018 compared to 2017 was due primarily to a full

year of lease expense at our new locations in Austin and Fort Worth, as well as our new executive location in Addison,

56

Texas. Expense associated with occupancy of premises increased \$530,000, or 7.7%, for the year ended December 31, 2017, as compared to \$6.9 million for the same period of 2016. The increase of \$530,000 in occupancy expenses for 2017 compared to 2016 was due primarily to increased lease expense due to new locations in Austin and Fort Worth, as well as additional automated teller machine servicing expense and security updates.

Amortization. Amortization costs include amortization of software and core deposit premiums. Amortization costs were \$1.2 million for the year ended December 31, 2018, an increase of \$195,000, or 18.9%, compared to \$1.0 million for the same period of 2017. Amortization costs for the year ended December 31, 2017 increased \$53,000, or 5.4%, compared to \$980,000 for the same period of 2016. The increases in amortization costs in both years were primarily due to amortization from core deposit intangibles resulting from the acquisitions of Westbound Bank in June 2018, and DCB Financial and Texas Leadership Bank in 2015, as well as additional software purchases required to support our expansion and to build the infrastructure needed for growth in the volume of our business.

Software Support. Software support expenses were \$2.5 million for the year ended December 31, 2018 and \$2.1 million for the same period in 2017. The increase of \$413,000, or 19.8%, was primarily attributable to additional online banking, core system and remote deposit capture software licensing due to the Westbound Bank acquisition and other organic growth and from new software purchased to monitor fraud and regulatory compliance requirements. Software support expenses increased \$219,000, or 11.7%, in 2017 from \$1.9 million for the year ended December 31, 2016. The increase was primarily attributable to incremental processing fees resulting from growth in volume of our loan and deposit accounts, as well as increased support fees from movement to a higher asset tier for our core processing software and the migration of traditional telecommunication lines at some locations to a cloud-based method of delivering communication lines, the expense of which is including in software support expenses rather than telecommunications expenses.

FDIC Assessment Fees. FDIC assessment fees were \$625,000 and \$671,000 for the years ended December 31, 2018 and 2017, respectively. The decrease of \$46,000, or 6.9%, resulted from a decrease in the FDIC assessment rates during 2018. FDIC assessment fees decreased \$529,000, or 44.1%, for the year ended December 31, 2017, compared to fees of \$1.2 million for the same period in 2016, which resulted from the effect of an update in our accounting methodology related to accrual of the assessment fees during 2016.

Legal and Professional Fees. Legal and professional fees, which include audit, loan review and regulatory assessments, were \$3.1 million and \$2.1 million for the years ended December 31, 2018 and 2017, respectively. The increase of \$1.0 million, or 49.4%, was primarily due to increases in legal, audit and professional fees related to our acquisition of Westbound Bank. The increase of \$126,000, or 6.5%, for the year ended December 31, 2017, compared to \$1.9 million for the year ended December 31, 2016, was primarily due to increases in legal, audit and professional fees as a result of our public company reporting requirements.

Advertising and Promotions. Advertising and promotion related expenses were \$1.4 million and \$1.2 million for the years ended December 31, 2018 and 2017, respectively. The increase of \$217,000, or 18.2%, was primarily due to increases in advertising expense in our growth markets, especially Central Texas, the Houston MSA and the Dallas/Fort Worth MSA. The increase of \$178,000, or 17.5%, for the year ended December 31, 2017, compared to \$1.0 million for the year ended December 31, 2016, was primarily due to additional advertising expense in our growth markets.

Telecommunication Expense. Telecommunications expenses include telephone, internet and television/cable expenses, which were \$649,000 and \$526,000 for the years ended December 31, 2018 and 2017, respectively. The increase of \$123,000, or 23.4%, was primarily due to the addition of our Houston, Austin and Fort Worth locations. The decrease of \$83,000, or 13.6%, for the year ended December 31, 2017, compared to \$609,000 for the year ended December 31, 2016, was primarily due to the migration of traditional telecommunication lines at some locations to a cloud-based method of delivering communication lines, the cost of which is included with software support expenses.

ATM and Debit Card Expense. We pay processing fees related to the activity of our customers' ATM and debit card usage. ATM and debit card expenses were \$1.1 million and \$899,000 for the years ended December 31, 2018 and 2017, respectively. Our expenses increased \$228,000, or 25.4%, due to increases in the number of deposit accounts, including those acquired from Westbound Bank, and the volume of ATM and debit card usage by our customers.

ATM and debit card expense decreased \$34,000, or 3.6%, for the year ended December 31, 2017, compared to \$933,000 for the year ended December 31, 2016, due to triggering of agreed upon contract renewal incentives during

the period.

57

Director and Committee Fees. We pay fees to our board of directors for their attendance at board and committee meetings for both the Company and the Bank. Director and committee fees paid were \$1.0 million and \$1.1 million for the years ended December 31, 2018 and 2017. The expense decreased \$35,000, or 3.3%, due to fewer committee meetings held during 2018 than in the prior year. Director and committee fees increased for the year ended December 31, 2017, by \$124,000, or 13.2%, compared to \$940,000 for the year ended December 31, 2016. This increase was due to an increase in the per-meeting fees paid to directors for 2017 and the addition of one new board member.

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, losses on sale of other real estate owned and other assets, other real estate owned expense and write-downs, business development expenses (i.e., travel and entertainment, charitable contributions and club memberships), insurance and security expenses. Other noninterest expense increased \$236,000, or 5.4%, from \$4.4 million for the year ended December 31, 2017 to \$4.6 million for the year ended December 31, 2018. The increase resulted primarily from increases in travel and lodging expenses related to our acquisition of Westbound Bank and additional loan processing and filing expenses, primarily from SBA loans acquired from Westbound. Other noninterest expense decreased \$49,000, or 1.1%, in 2017 compared to 2016. The decrease was primarily due to overall improved efficiencies and decreases in expenses such as office supplies and loan filing expenses.

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.

The Tax Cuts and Jobs Act of 2017 was signed into law by President Trump on December 22, 2017, and reduced the corporate tax rate, beginning on January 1, 2018, from 35% to 21%. As a result of the signing of this law, we recorded during the fourth quarter of 2017, a one-time, non-cash charge to income tax provision of \$1.7 million to reduce the value of our net deferred tax assets due to the new tax rate at which they are expected to reverse.

For the years ended December 31, 2018, 2017, and 2016, income tax expense totaled \$4.6 million, \$8.2 million, including the one-time deferred tax asset adjustment of \$1.7 million described above, and \$4.7 million, respectively. Our effective tax rate for the years ended December 31, 2018, 2017 and 2016 was 18.3%, 36.3%, and 28.0%, respectively.

Financial Condition

Our total assets increased \$304.3 million, or 15.5%, from \$1.96 billion as of December 31, 2017 to \$2.27 billion as of December 31, 2018. Our asset growth in 2018 was primarily due to the acquisition of Westbound Bank in the Houston MSA, continued organic growth and maturity of our Central Texas and Dallas/Fort Worth MSA markets, including a full year of operations in 2018 for our de novo branches in Austin and Fort Worth, Texas, by enhancing our lending and deposit relationships with existing customers and attracting new customers, as well as cross-selling our deposit and treasury management products. Total assets increased \$134.3 million, or 7.3%, from \$1.83 billion as of December 31, 2016 to \$1.96 billion as of December 31, 2017. Our growth in 2017 was primarily organic, with growth in both our traditional East Texas markets and in our maturing Central Texas and Dallas/Fort Worth MSA markets.

Loan Portfolio

Our primary source of income is interest earned on loans to small- to medium-sized businesses, commercial companies, professionals and individuals located in our primary market areas. A substantial portion of our loan portfolio consists of commercial and industrial loans and real estate loans secured by commercial real estate properties located in our primary market areas. Our loan portfolio represents the highest yielding component of our earning asset base.

As of December 31, 2018, total loans, excluding deferred loan fees, were \$1.66 billion, an increase of \$300.0 million, or 22.1%, compared to \$1.36 billion as of December 31, 2017. The increase during 2018 was primarily due to the acquisition of \$154.7 million in loans from Westbound Bank and from continued organic growth in our primary market areas, including de novo locations in Austin and Fort Worth, Texas. Loan growth was slightly offset by the sale of \$10.2 million in loans in connection with the sale of our Atlanta, Texas bank location in December 2018. Total loans as of December 31, 2017 represented an increase of \$115.6 million, or 9.3%, compared to \$1.24 billion as of December 31, 2016. The increase during 2017 was primarily due to continued organic growth in our primary market areas and opening of de novo locations in Austin and Fort Worth, Texas in November 2017. In addition to these amounts, \$1.8 million, \$1.9 million and \$2.6 million in loans were classified as held for sale as of December 31, 2018, 2017 and 2016, respectively.

Total loans, excluding loans held for sale, as a percentage of deposits were 88.7%, 81.1% and 78.9% as of December 31, 2018, 2017 and 2016, respectively. Total loans, excluding loans held for sale, as a percentage of assets were 73.2%, 69.3% and 68.0% as of December 31, 2018, 2017 and 2016, respectively.

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

	As of December 31,		2017		2016		2015		2014	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Commercial and industrial	\$261,779	15.77 %	\$197,508	14.53 %	\$223,712	17.98 %	\$181,716	17.02 %	\$139,258	17.71 %
Real estate:										
Construction and development	237,503	14.31 %	196,774	14.47 %	129,631	10.42 %	122,904	11.51 %	77,760	9.89 %
Commercial real estate	582,519	35.10 %	418,137	30.76 %	368,077	29.59 %	301,910	28.29 %	205,648	26.15 %
Farmland	67,845	4.09 %	59,023	4.34 %	62,366	5.01 %	47,668	4.47 %	34,131	4.34 %
1-4 family residential	393,067	23.69 %	374,371	27.54 %	361,665	29.07 %	312,306	29.26 %	245,889	31.26 %
Multi-family residential	38,386	2.31 %	36,574	2.69 %	26,079	2.10 %	30,395	2.85 %	24,075	3.06 %
Consumer and overdrafts	55,159	3.32 %	51,561	3.79 %	53,494	4.30 %	50,954	4.77 %	44,439	5.65 %
Agricultural	23,277	1.40 %	25,596	1.88 %	18,901	1.52 %	19,524	1.83 %	15,319	1.95 %

Edgar Filing: GUARANTY BANCSHARES INC /TX/ - Form 10-K

Total loans held for investment	\$1,659,535	100.00%	\$1,359,544	100.00%	\$1,243,925	100.00%	\$1,067,377	100.00%	\$786,519	100.00%
Total loans held for sale	\$1,795		\$1,896		\$2,563		\$3,867		\$3,915	

Commercial and Industrial Loans. Commercial and industrial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and effectively. These 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 generally include personal guarantees. Commercial and industrial loans increased \$64.3 million, or 32.5%, to \$261.8 million as of December 31, 2018 from \$197.5 million as of December 31, 2017. Commercial and industrial loans as of December 31, 2017 represented a decrease of \$26.2 million, or 11.7%, from \$223.7 million as of December 31, 2016. The fluctuations in the commercial and industrial portfolio in both years is primarily due to normal variances in the balances of underlying lines of credit and was impacted in 2018 by the loans acquired from Westbound Bank.

Construction and Development. Construction and land development loans are comprised of loans to fund construction, land acquisition and land development construction. The properties securing the portfolio are located throughout Texas and are generally diverse in terms of type. Construction and development loans increased \$40.7 million, or 20.7%, to \$237.5 million as of December 31, 2018 from \$196.8 million as of December 31, 2017. Construction and development loans as of December 31, 2017 represented an increase of \$67.1 million, or 51.8%, from \$129.6 million as of December 31, 2016. The increases in both years resulted from continued organic growth, especially in our Central Texas and Dallas/Fort Worth MSA markets, as well as increases in market demand and our decision in 2017 to seek a larger volume of such loans due to our belief that our loan portfolio was sufficiently diverse to sustain them. The increase in 2018 was also impacted by the loans acquired from Westbound Bank.

1-4 Family Residential. Our 1-4 family residential loan portfolio is comprised of loans secured by 1-4 family homes, which are both owner occupied and investor owned. Our 1-4 family residential loans have a relatively small balance spread between many individual borrowers compared to our other loan categories. Our 1-4 family residential loans increased \$18.7 million, or 5.0%, to \$393.1 million as of December 31, 2018 from \$374.4 million as of December 31, 2017. Our 1-4 family residential loans as of December 31, 2017 represented an increase of \$12.7 million, or 3.5%, from \$361.7 million as of December 31, 2016. This increases in both years were primarily the result of continued organic growth.

Commercial Real Estate. Commercial real estate loans are underwritten primarily based on projected cash flows and, secondarily, as loans secured by real estate. These loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the portfolio are located primarily within our markets and are generally diverse in terms of type. This diversity helps reduce our exposure to adverse economic events that affect any single industry. Commercial real estate loans increased \$164.4 million, or 39.3%, to \$582.5 million as of December 31, 2018 from \$418.1 million as of December 31, 2017. Commercial real estate loans as of December 31, 2017 represented an increase of \$50.1 million, or 13.6%, from \$368.1 million as of December 31, 2016. The increase in commercial real estate loans during these periods was mostly driven by a general increase in lending activity, primarily in our Central Texas and Dallas/Fort Worth MSA markets, and the growth in 2018 was impacted by the loans acquired from Westbound Bank.

Other Loan Categories. Other categories of loans included in our loan portfolio include farmland and agricultural loans made to farmers and ranchers relating to their operations, multi-family residential loans and consumer loans. None of these categories of loans represents a significant portion of our total loan portfolio.

Contractual Loan Maturities. The contractual maturity ranges of loans in our loan portfolio and the amount of such loans with fixed and floating interest rates in each maturity range as of date indicated are summarized in the following tables:

	As of December 31, 2018			
	One Year or Less	One Through Five Years	After Five Years	Total
	(Dollars in thousands)			
Commercial and industrial	\$ 137,706	\$ 93,119	\$ 30,954	\$ 261,779
Real estate:				
Construction and development	90,830	81,731	64,942	237,503
Commercial real estate	30,374	147,722	404,423	582,519
Farmland	5,319	12,683	49,843	67,845
1-4 family residential	27,344	33,601	332,122	393,067
Multi-family residential	20,010	7,523	10,853	38,386
Consumer	17,586	34,042	3,531	55,159
Agricultural	13,791	9,364	122	23,277
Total loans	\$ 342,960	\$ 419,785	\$ 896,790	\$ 1,659,535
Amounts with fixed rates	\$ 229,710	\$ 327,545	\$ 48,972	\$ 606,227
Amounts with floating rates	\$ 113,250	\$ 92,240	\$ 847,818	\$ 1,053,308

	As of December 31, 2017			
	One Year or Less	One Through Five Years	After Five Years	Total
	(Dollars in thousands)			
Commercial and industrial	\$ 106,487	\$ 62,367	\$ 28,654	\$ 197,508
Real estate:				
Construction and development	70,911	57,123	68,740	196,774
Commercial real estate	15,955	65,600	336,582	418,137
Farmland	5,049	4,478	49,496	59,023
1-4 family residential	24,514	26,653	323,204	374,371
Multi-family residential	20,385	8,021	8,168	36,574
Consumer	15,494	33,602	2,465	