

MIDSOUTH BANCORP INC
Form 10-K
March 16, 2018

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, 2017
Commission File number 1-11826

MIDSOUTH BANCORP, INC.

(Exact name of registrant as specified in its charter)

Louisiana 72-1020809

(State of Incorporation) (I.R.S. EIN Number)

102 Versailles Boulevard, Lafayette, Louisiana 70501

(Address of principal executive offices)

Registrant's telephone number, including area code: (337) 237-8343

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

Title of each class	Name of each exchange on which registered
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Common Stock, \$.10 par value	New York Stock Exchange
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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 No

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

Yes No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K 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 nonaccelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company," in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer	<input checked="" type="checkbox"/> Nonaccelerated filer	Smaller reporting company	Emerging growth company
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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 voting and nonvoting common equity held by nonaffiliates of the registrant at June 30, 2017 was approximately \$158,085,769 based upon the closing market price per share of the registrant's common

stock as reported on

The New York Stock Exchange, Inc. as of such date. As of March 16, 2018 there were 16,621,811 outstanding shares of MidSouth Bancorp, Inc. common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's Proxy Statement for its 2018 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

MIDSOUTH BANCORP, INC.
 2017 Annual Report on Form 10-K
 TABLE OF CONTENTS

<u>PART I</u>	<u>7</u>
<u>Item 1 - Business</u>	<u>7</u>
<u>Overview</u>	<u>7</u>
<u>Products and Services</u>	<u>7</u>
<u>Markets</u>	<u>7</u>
<u>Competition</u>	<u>7</u>
<u>Employees</u>	<u>8</u>
<u>Additional Information</u>	<u>8</u>
<u>Supervision and Regulation</u>	<u>8</u>
<u>Item 1A – Risk Factors</u>	<u>16</u>
<u>Risks Relating to Our Business</u>	<u>16</u>
<u>Risks Relating to an Investment in Our Common Stock</u>	<u>23</u>
<u>Item 1B – Unresolved Staff Comments</u>	<u>25</u>
<u>Item 2 - Properties</u>	<u>25</u>
<u>Item 3 - Legal Proceedings</u>	<u>26</u>
<u>Item 4 – Mine Safety Disclosures</u>	<u>26</u>
<u>Executive Officers of the Registrant</u>	<u>27</u>
<u>PART II</u>	<u>28</u>
<u>Item 5 - Market for Registrant's Common Equity, Related Shareholder Matters, and Issuer Purchases of Equity Securities</u>	<u>28</u>
<u>Item 6 – Five Year Summary of Selected Financial Data</u>	<u>30</u>
<u>Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>30</u>
<u>Overview</u>	<u>30</u>
<u>Critical Accounting Policies</u>	<u>31</u>
<u>Results of Operations</u>	<u>32</u>
<u>Earnings Analysis</u>	<u>33</u>
<u>Balance Sheet Analysis</u>	<u>38</u>
<u>Impact of Inflation and Changing Prices</u>	<u>49</u>
<u>Non-GAAP Financial Measures</u>	<u>49</u>
<u>Item 7A – Quantitative and Qualitative Disclosures about Market Risk</u>	<u>51</u>
<u>Item 8 – Financial Statements and Supplementary Data</u>	<u>52</u>
<u>Notes to Consolidated Financial Statements</u>	<u>58</u>
1. <u>SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES</u>	<u>58</u>
2. <u>INVESTMENT SECURITIES</u>	<u>64</u>
3. <u>LOANS</u>	<u>68</u>
4. <u>PREMISES AND EQUIPMENT</u>	<u>77</u>
5. <u>GOODWILL AND OTHER INTANGIBLE ASSETS</u>	<u>77</u>
6. <u>DEPOSITS</u>	<u>78</u>
7. <u>SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE</u>	<u>78</u>
8. <u>SHORT-TERM FEDERAL HOME LOAN BANK ADVANCES</u>	<u>79</u>
9. <u>LONG-TERM FEDERAL HOME LOAN BANK ADVANCES</u>	<u>79</u>
10. <u>JUNIOR SUBORDINATED DEBENTURES</u>	<u>79</u>
11. <u>COMMITMENTS AND CONTINGENCIES</u>	<u>79</u>

12. <u>INCOME TAXES</u>	<u>80</u>
13. <u>EMPLOYEE BENEFITS</u>	<u>81</u>
14. <u>EMPLOYEE STOCK PLANS</u>	<u>82</u>

15. <u>STOCKHOLDERS' EQUITY</u>	<u>84</u>
16. <u>DERIVATIVES</u>	<u>85</u>
17. <u>OTHER COMPREHENSIVE (LOSS) INCOME</u>	<u>86</u>
18. <u>NET EARNINGS PER COMMON SHARE</u>	<u>87</u>
19. <u>FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK</u>	<u>88</u>
20. <u>REGULATORY MATTERS</u>	<u>88</u>
21. <u>FAIR VALUE MEASUREMENTS AND DISCLOSURES</u>	<u>90</u>
22. <u>OTHER NON-INTEREST INCOME AND EXPENSE</u>	<u>94</u>
23. <u>SUBSEQUENT EVENTS</u>	<u>95</u>
24. <u>CONDENSED FINANCIAL INFORMATION OF PARENT COMPANY</u>	<u>96</u>
<u>Item 9 – Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	<u>102</u>
<u>Item 9A – Controls and Procedures</u>	<u>102</u>
<u>Item 9B – Other Information</u>	<u>102</u>
<u>PART III</u>	<u>103</u>
<u>Item 10 - Directors, Executive Officers, and Corporate Governance</u>	<u>103</u>
<u>Item 11 - Executive Compensation</u>	<u>103</u>
<u>Item 12 - Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters</u>	<u>103</u>
<u>Securities Authorized for Issuance under Equity Compensation Plans</u>	<u>103</u>
<u>Item 13 - Certain Relationships and Related Transactions and Director Independence</u>	<u>104</u>
<u>Item 14 – Principal Accounting Fees and Services</u>	<u>104</u>
<u>Item 15 - Exhibits and Financial Statement Schedules</u>	<u>104</u>
<u>Item 16 - Form 10-K Summary</u>	<u>106</u>

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements included in this Report and the documents incorporated by reference herein, other than statements of historical fact, are forward-looking statements (as such term is defined in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and the regulations thereunder), which are intended to be covered by the safe harbors created thereby. Forward-looking statements include, but are not limited to certain statements under the captions “Business,” “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

The words “anticipate,” “believe,” “estimate,” “expect,” “intend,” “may,” “plan,” “will,” “would,” “could,” “should,” “guidance,” “continue,” “project,” “forecast,” “confident,” and similar expressions are typically used to identify forward-looking statements. These statements are based on assumptions and assessments made by management in light of their experience and their perception of historical trends, current conditions, expected future developments and other factors they believe to be appropriate. Any forward-looking statements are not guarantees of our future performance and are subject to risks and uncertainties and may be affected by various factors that may cause actual results, developments and business decisions to differ materially from those in the forward-looking statements. Some of the factors that may cause actual results, developments and business decisions to differ materially from those contemplated by such forward-looking statements include the factors discussed under the caption “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in this Report and the following:

- changes in interest rates and market prices that could affect the net interest margin, asset valuation, and expense levels;
- changes in local economic and business conditions in the markets we serve, including, without limitation, changes related to the oil and gas industries that could adversely affect customers and their ability to repay borrowings under agreed upon terms, adversely affect the value of the underlying collateral related to their borrowings, and reduce demand for loans;
- increases in competitive pressure in the banking and financial services industries;
- increased competition for deposits and loans which could affect compositions, rates and terms;
- changes in the levels of prepayments received on loans and investment securities that adversely affect the yield and value of the earning assets;
- our ability to successfully implement and manage our recently announced strategic initiatives;
- costs and expenses associated with our strategic initiatives and possible changes in the size and components of the expected costs and charges associated with our strategic initiatives;
- our ability to realize the anticipated benefits and cost savings from our strategic initiatives within the anticipated time frame, if at all;
- the ability of our strategic initiatives to adequately address the concerns of the Office of the Comptroller of the Currency (the “OCC”) in its previous examination of us and the ability of the Company to comply with the terms of the formal agreement with the OCC;
- credit losses due to loan concentration, particularly our energy lending and commercial real estate portfolios;
- a deviation in actual experience from the underlying assumptions used to determine and establish our allowance for loan losses (“ALL”), which could result in greater than expected loan losses;
- the adequacy of the level of our ALL and the amount of loan loss provisions required in future periods including the impact of implementation of the new CECL (current expected credit loss) methodology;
- future examinations by our regulatory authorities, including the possibility that the regulatory authorities may, among other things, impose conditions on our operations or require us to increase our allowance for loan losses or write-down assets;
- changes in the availability of funds resulting from reduced liquidity or increased costs;
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the timing and impact of future acquisitions or divestitures, the success or failure of integrating acquired operations, and the ability to capitalize on growth opportunities upon entering new markets;

the ability to acquire, operate, and maintain effective and efficient operating systems;

increased asset levels and changes in the composition of assets that would impact capital levels and regulatory capital ratios;

loss of critical personnel and the challenge of hiring qualified personnel at reasonable compensation levels;

legislative and regulatory changes, including the impact of regulations under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and other changes in banking, securities and tax laws and regulations and their application by our regulators, changes in the scope and cost of FDIC insurance and other coverage;

regulations and restrictions resulting from our participation in government-sponsored programs such as the U.S. Treasury's Small Business Lending Fund, including potential retroactive changes in such programs; changes in accounting principles, policies, and guidelines applicable to financial holding companies and banking; increases in cybersecurity risk, including potential business disruptions or financial losses; acts of war, terrorism, cyber intrusion, weather, or other catastrophic events beyond our control; and the ability to manage the risks involved in the foregoing

We can give no assurance that any of the events anticipated by the forward-looking statements will occur or, if any of them does, what impact they will have on our results of operations and financial condition. We disclaim any intent or obligation to publicly update or revise any forward-looking statements, regardless of whether new information becomes available, future developments occur or otherwise.

Part I

Item 1 - Business

Overview

The Company was incorporated in 1984 as a Louisiana corporation and is a registered bank holding company headquartered in Lafayette, Louisiana. Its operations have been conducted primarily through its wholly owned bank subsidiary MidSouth Bank, N.A. The Bank, a national banking association, was chartered and commenced operations in 1985. As of December 31, 2017, the Bank operated through a network of 48 offices located in Louisiana and Texas.

Unless otherwise indicated or unless the context requires otherwise, all references in this report to “the Company,” “we,” “us,” “our,” or similar references, mean MidSouth Bancorp, Inc. and our subsidiaries, including our banking subsidiary, MidSouth Bank, N.A., on a consolidated basis. References to “MidSouth Bank” or the “Bank” mean our wholly owned banking subsidiary, MidSouth Bank, N.A.

Products and Services

The Bank is community oriented and focuses primarily on offering commercial and consumer loan and deposit services to small and middle market businesses, their owners and employees, and other individuals in our markets. Our community banking philosophy emphasizes personalized service and building broad customer relationships. Deposit products and services offered by the Bank include interest-bearing and noninterest-bearing checking accounts, investment accounts, cash management services, and electronic banking services, including remote deposit capturing services, internet banking, and debit and credit cards. Most of the Bank’s deposit accounts are FDIC-insured up to the maximum allowed, and the Bank customers have access to a world-wide ATM network of more than 55,000 surcharge-free ATMs.

Loans offered by the Bank include commercial and industrial loans, commercial real estate loans (both owner-occupied and non-owner occupied), other loans secured by real estate and consumer loans.

We are committed to an exceptional level of customer care. We maintain our own in-house call center so that customers enjoy live interaction with employees of the Bank rather than an automated telephone system. Additionally, we provide our employees with the training and technological tools to improve customer care. We also conduct focus groups within the communities we serve and strive to create a two-way dialog to ensure that we are offering the banking products and services that our customers and communities need.

Markets

We operate in Louisiana and central and east Texas along the Interstate 10, Interstate 49, Highway 90, Interstate 45, Interstate 20 and Interstate 35 corridors. As of December 31, 2017, our market area in Louisiana included 35 offices and is bound by Lafourche Parish to the south, East Baton Rouge Parish to the east, Caddo Parish to the north and Calcasieu Parish to the west. Our market areas in Texas include 13 offices located in the Beaumont, Houston, Conroe, Magnolia, College Station, Texarkana, Tyler and Dallas areas. For additional information regarding our properties, see Item 2 – Properties of this Report.

Oil and gas is the key industry within our markets. However, medical, technology and research companies continue to develop within these markets thereby diversifying the economy. Additionally, numerous major universities located within our market areas, including Louisiana State University, University of Houston, Rice University, Texas A&M

University and University of Louisiana at Lafayette, provide a substantial number of jobs and help to contribute to the educated work force within our markets.

Competition

We face strong competition in our market areas from both traditional and nontraditional financial services providers, such as commercial banks; savings banks; credit unions; finance companies; mortgage, leasing, and insurance companies; money market mutual funds; brokerage houses; and branches that provide credit facilities. Several of the financial services competitors in our market areas are substantially larger and have far greater resources; however, we have effectively competed by building long-term customer relationships. Customer loyalty has been built through our continued focus on quality customer care enhanced by technology and effective delivery systems.

Other factors, including economic, legislative, and technological changes, also impact our competitive environment. Management continually evaluates competitive challenges in the financial services industry and develops appropriate responses consistent with our overall market strategy.

Employees

As of December 31, 2017, the Bank employed approximately 467 full-time equivalent employees. The Company had no employees who are not also employees of the Bank. Through the Bank, employees receive customary employee benefits, which include an employee stock ownership plan; a 401(K) plan; and life, health and disability insurance plans. Our directors, officers, and employees are important to the success of the Company and play a key role in business development by actively participating in the communities served by the Company. The Company considers the relationship of the Bank with its employees as a whole to be good.

Additional Information

More information on the Company and the Bank is available on the Bank's website at www.midsouthbank.com. The Company is not incorporating by reference into this Report the information contained on its website; therefore, the content of the website is not a part of this Report. Copies of this Report and other reports filed or furnished by the Company pursuant to Section 13(a) or 15(d) of the Exchange Act, including exhibits, are available free of charge on the Company's website under the "Investor Relations" link as soon as reasonably practicable after they have been filed or furnished electronically to the Securities and Exchange Commission ("SEC"). Copies of these filings may also be obtained free of charge on the SEC's website at www.sec.gov.

Supervision and Regulation

Under Federal Reserve policy, we are expected to act as a source of financial strength for, and to commit resources to support, the Bank. This support may be required at times when, absent such Federal Reserve policy, we may not be inclined to provide such support. In addition, any capital loans by a bank holding company to any of its banking subsidiaries are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary banks. In the event of a bank holding company's bankruptcy, any commitment by a bank holding company to a federal bank regulatory agency to maintain the capital of a banking subsidiary will be assumed by the bankruptcy trustee and entitled to a priority of payment.

Troubled Condition and Written Agreement

On December 27, 2017, the Company was informed in writing by the Federal Reserve Bank of Atlanta ("FRB Atlanta") that the FRB Atlanta has determined that the Company is in "troubled condition" for purposes of Section 225.71 of Regulation Y. Based on the troubled condition determination, the Company (1) must notify the FRB Atlanta prior to adding or replacing a member of its board of directors or employing, or changing the responsibilities of, any senior executive officer, and (2) may not, except under certain circumstances, enter into any agreements to make severance or indemnification payments or make any such payments to "institution-affiliated parties" as defined in the regulations.

On June 8, 2017, the Bank was informed by the Office of the Comptroller of the Currency ("OCC") that the OCC has determined that the Bank is in "troubled condition" for purposes of 12 C.F.R. 5.51, Changes in Directors and Senior Executive Officers, which implements the provisions of Section 914 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, 12 U.S.C. 1831i, and, as a result, the Bank is subject to specified restrictions on its operations. The OCC's determination was based on deficiencies identified in its examination of the Bank, including but not limited to deficiencies in asset quality, credit administration and strategic planning. Based on the troubled condition determination, the Bank is now subject to the following restrictions on its operations: (1) the Bank must seek approval from the OCC prior to adding or replacing a member of its board of directors, or employing, or

changing the responsibilities of any senior executive officer, and (2) the Bank may not, except under certain circumstances, enter into any agreements to make severance or indemnification payments or make any such payments to “institution-affiliated parties” as defined in the regulations.

On July 19, 2017, the Bank entered into a formal written agreement with the OCC that provides, among other things, that the Bank: (i) create a committee to monitor the Bank’s compliance with the Agreement and make quarterly reports to the Board of Directors and the OCC; (ii) adopt and implement a three-year strategic plan for the Bank consistent with regulatory guidance and to be reviewed and updated on at least an annual basis by the Board of Directors; (iii) protect its interests in its criticized assets (those assets classified as “doubtful,” “substandard,” or “special mention” by internal or external loan review or examination), and adopt and implement a written program designed to eliminate the basis of criticism of criticized assets equal

to or exceeding \$250,000, which shall be reviewed and, as necessary, revised, on a quarterly basis; (iv) may not extend additional credit to any borrower with an aggregate outstanding loan balance of \$250,000 that is a criticized asset unless approved and deemed by the Bank's Board of Directors to be necessary to promote the best interests of the Bank and will not compromise the Bank's written program with respect to such loans; (v) develop and implement a written program to improve the Bank's loan portfolio management and provide the Board of Directors with written reports on the Bank's loan portfolio to enhance problem loan identification; (vi) review and, as necessary, revise the Bank's loan review program to ensure the timely identification and categorization of problem credits consistent with regulatory guidance; (vii) adopt and implement certain enhancements to its policies and procedures relating to its ALLL and the methodology related thereto; and (viii) revise its internal audit program to ensure Bank adherence to an independent and comprehensive internal audit program.

Regulatory Reform

The financial crisis of 2008, including the downturn of global economic, financial and money markets and the threat of collapse of numerous financial institutions, and other recent events have led to the adoption of numerous new laws and regulations that apply to, and focus on, financial institutions. The most significant of these new laws is the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which was adopted on July 21, 2010 and, in part, is intended to implement significant structural reforms to the financial services industry. The Dodd-Frank Act is discussed in more detail below.

Bank Holding Companies

Historically, the activities of bank holding companies were limited to the business of banking and activities closely related or incidental to banking. Bank holding companies were generally prohibited from acquiring control of any company that was not a bank and from engaging in any business other than the business of banking or managing and controlling banks. The Gramm-Leach-Bliley Act, which took effect on March 12, 2000, dismantled many Depression-era restrictions against affiliation between banking, securities and insurance firms by permitting bank holding companies to engage in a broader range of financial activities, so long as certain safeguards are observed. Specifically, bank holding companies may elect to become "financial holding companies" that may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or incidental to a financial activity.

We elected to become a financial holding company in November 2012. However, related to the regulatory issues discussed above under "Troubled Condition and Written Agreement," we decertified as a financial holding company in November 2017. We remain a bank holding company under the Federal Bank Holding Company Act.

Dodd-Frank Act

In July 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank Act implemented far-reaching changes across the financial regulatory landscape, including changes that have affected all bank holding companies and banks, including us and the Bank, including the following provisions:

Insurance of Deposit Accounts. The Dodd-Frank Act changed the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital. The Dodd-Frank Act also made permanent the \$250,000 limit for federal deposit insurance and increased the cash limit of Securities Investor Protection Corporation protection from \$100,000 to \$250,000.

Payment of Interest on Demand Deposits. The Dodd-Frank Act repealed the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.

Creation of the Consumer Financial Protection Bureau. The Dodd-Frank Act centralized significant aspects of consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau (the "CFPB"), which is discussed in more detail below.

Debit Card Interchange Fees. The Dodd-Frank Act amended the Electronic Fund Transfer Act to, among other things, require that debit card interchange fees be reasonable and proportional to the actual cost incurred by the issuer with respect to the transaction. In June 2011, the Federal Reserve Board adopted regulations setting the maximum permissible interchange fee as the sum of 21 cents per transaction and 5 basis points multiplied by the value of the transaction, with an additional adjustment of up to one cent per transaction if the issuer implements additional fraud-prevention standards. Although issuers that have assets of less than \$10 billion are exempt from the Federal Reserve Board's regulations that set maximum interchange fees, these regulations could significantly impact the interchange fees that financial institutions with less than \$10 billion in assets, such as the Bank, are able to collect.

In addition, the Dodd-Frank Act implements other far-reaching changes to the financial regulatory landscape, including provisions that:

- 9 -

- restrict the preemption of state law by federal law and disallow subsidiaries and affiliates of national banks from availing themselves of such preemption;
- impose comprehensive regulation of the over-the-counter derivatives market, subject to significant rulemaking processes, which would include certain provisions that would effectively prohibit insured depository institutions from conducting certain derivatives businesses in the institution itself;
- require depository institutions with total consolidated assets of more than \$10 billion to conduct regular stress tests and require large, publicly traded bank holding companies to create a risk committee responsible for the oversight of enterprise risk management;
- require loan originators to retain 5% of any loan sold or securitized, unless it is a “qualified residential mortgage,” subject to certain exceptions;
- prohibit banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (the Volcker Rule); and
- implement corporate governance revisions that apply to all public companies, not just financial institutions.

While much of the Dodd-Frank Act has been implemented in the form of final rules from the banking agencies, the full extent of the impact such requirements will have on our operations continues to be unclear. In addition, the current administration in the U.S. has added further uncertainty as to the implementation, scope and timing of additional rules implementing the Dodd-Frank Act, and it is possible that existing rules may be modified or repealed. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain aspects 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. While we cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have on us, these changes could be materially adverse to us and our investors, even if only in the short-term.

Capital Requirements

We are subject to various regulatory capital requirements administered by the Federal Reserve and the OCC. Failure to meet minimum capital requirements could result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action (described below), we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting policies. Our capital amounts and classification are also subject to judgments by the regulators regarding qualitative components, risk weightings, and other factors. For further detail on capital and capital ratios, see the discussion under Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Basel III Capital Framework

The federal bank regulatory agencies have adopted rules to implement the Basel III capital framework as outlined by the Basel Committee on Banking Supervision and standards for calculating risk-weighted assets and risk-based capital measurements (collectively, the “Basel III Final Rules”). For purposes of these capital rules, (i) common equity Tier 1 capital (“CET1”) consists principally of common stock (including surplus) and retained earnings; (ii) Tier 1 capital consists principally of CET1 plus non-cumulative preferred stock and related surplus, and certain grandfathered cumulative preferred stock and trust preferred securities; and (iii) Tier 2 capital consists principally of Tier 1 capital plus qualifying subordinated debt and preferred stock, and limited amounts of an institution’s allowance for loan losses. Each regulatory capital classification is subject to certain adjustments and limitations, as implemented by the

Basel III Final Rules. The Basel III Final Rules also establish risk weightings that are applied to many classes of assets held by community banks, including, importantly, applying higher risk weightings to certain commercial real estate loans. The Company and the Bank are subject to the Basel III capital ratios.

The Basel III Final Rules were effective on January 1, 2015, and the Basel III Final Rules' capital conservation buffer (as described below) is being phased in beginning January 1, 2016 through 2019. When fully phased in, the Basel III Final Rules require banks to maintain (i) a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% CET1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7%), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of total (that is, Tier 1 plus Tier 2) capital to risk-

- 10 -

weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation) and (iv) a minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (computed as the average for each quarter of the month-end ratios for the quarter).

The Basel III Final Rules provide deductions from and adjustments to regulatory capital measures, and primarily to CET1, including deductions and adjustments that were not applied to reduce CET1 under historical regulatory capital rules. For example, mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities must be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. These deductions from and adjustments to regulatory capital are generally subject to a phase in period, which began in 2015 and will continue through 2018.

The Basel III Final Rules also implement a “countercyclical capital buffer,” generally designed to absorb losses during periods of economic stress and to be imposed when national regulators determine that excess aggregate credit growth becomes associated with a buildup of systemic risk. This buffer is a CET1 add-on to the capital conservation buffer in the range of 0% to 2.5% when fully implemented (potentially resulting in total buffers of between 2.5% and 5%).

In addition, the OCC has established higher individual minimum capital ratios for the Bank. Specifically, the Bank must maintain a Tier 1 leverage ratio of at least 8%, and a total risk-based capital ratio of at least 12%.

At December 31, 2017, our CET1 to risk-weighted assets ratio was 12.10%, our Tier 1 Capital to risk-weighted assets ratio was 16.51%, our Total Capital to risk-weighted assets ratio was 17.77% and our Leverage Ratio was 12.53%. Since our total consolidated assets are below \$15 billion, our \$21.5 million aggregate principal amount of trust preferred securities issued prior to May 19, 2011, are included in our Tier 1 and Total Capital calculations.

The Volcker Rule

The Dodd-Frank Act required the federal bank regulatory agencies to adopt rules that prohibit banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (defined as hedge funds and private equity funds). The statutory provision is commonly called the “Volcker Rule.” On December 10, 2013, the Federal Reserve and other federal agencies issued final rules to implement the Volcker Rule. In relevant part, these final rules would have prohibited banking entities from owning collateralized debt obligations (CDOs) backed by trust preferred securities (TruPS), effective July 21, 2015. However, subsequent to these final rules the U.S. financial regulatory agencies issued an interim rule to exempt CDOs backed by TruPS from the Volcker Rule and the final rule, provided that (a) the CDO was established prior to May 19, 2010, (b) the banking entity reasonably believes that the CDO’s offering proceeds were used to invest primarily in TruPS issued by banks with less than \$15 billion in assets, and (iii) the banking entity acquired the CDO investment on or before December 10, 2013. At December 31, 2017, we did not have any CDOs backed by TruPS.

The Durbin Amendment

The Dodd-Frank Act included provisions which restrict interchange fees to those which are “reasonable and proportionate” for certain debit card issuers, and limit the ability of networks and issuers to restrict debit card transaction routing. This statutory provision is known as the “Durbin Amendment.” The Federal Reserve issued final rules implementing the Durbin Amendment on June 29, 2011. In the final rules, interchange fees for debit card transactions were capped at \$0.21 plus five basis points in order to be eligible for a safe harbor such that the fee is conclusively determined to be reasonable and proportionate. Another related rule also permits an additional \$0.01 per transaction “fraud prevention adjustment” to the interchange fee if certain Federal Reserve standards are implemented, including an annual review of fraud prevention policies and procedures. With respect to network exclusivity and merchant routing restrictions, it is now required that all debit cards participate in at least two

unaffiliated networks so that the transactions initiated using those debit cards will have at least two independent routing channels. While the interchange fee restrictions contained in the Durbin Amendment, and the rules promulgated thereunder, only apply to debit card issuers with \$10 billion or more in total consolidated assets, these regulations could significantly affect the interchange fees that financial institutions with less than \$10 billion in assets, including the Bank, are able to collect.

Prompt Corrective Action

The Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”) established a system of prompt corrective action to resolve the problems of undercapitalized institutions. Under this system, the federal banking regulators have established five capital categories (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized) and are required to take certain mandatory supervisory actions, and are authorized to take other discretionary actions, with respect to institutions in the three undercapitalized categories. The severity of the action will depend upon the

- 11 -

capital category in which the institution is placed. Generally, subject to a narrow exception, the banking regulator must appoint a receiver or conservator for an institution that is critically undercapitalized. The federal banking agencies have set the relevant capital level for each category.

An institution that is categorized as undercapitalized, significantly undercapitalized, or critically undercapitalized is required to submit an acceptable capital restoration plan to its appropriate federal regulatory agency. A bank holding company must guarantee that a subsidiary depository institution meets its capital restoration plan, subject to certain limitations. The controlling holding company's obligation to fund a capital restoration plan is limited to the lesser of 5.0% of an undercapitalized subsidiary's assets or the amount required to meet regulatory capital requirements. An undercapitalized institution is also generally prohibited from increasing its average total assets, making acquisitions, establishing any branches or engaging in any new line of business, except under an accepted capital restoration plan or with FDIC approval. In addition, the appropriate federal regulatory agency may treat an undercapitalized institution in the same manner as it treats a significantly undercapitalized institution if it determines that those actions are necessary.

At December 31, 2017, the Bank had the requisite capital level to qualify as “well capitalized” under the regulatory framework for prompt corrective action.

Insurance of Accounts and FDIC Insurance Assessments

The Bank's deposits are insured by the Deposit Insurance Fund (the “DIF”) of the FDIC up to the standard maximum insurance amount for each deposit insurance ownership category. Since January 1, 2013, the basic limit on FDIC deposit insurance coverage has been \$250,000 per depositor. Under the FDIA, the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC, subject to administrative and potential judicial hearing and review processes.

The DIF is funded by assessments on banks and other depository institutions. As required by the Dodd-Frank Act, in February 2011, the FDIC approved a final rule that changed the assessment base for DIF assessments from domestic deposits to average consolidated total assets minus average tangible equity (defined as Tier 1 capital). In addition, as also required by the Dodd-Frank Act, the FDIC has adopted a new large-bank pricing assessment scheme, set a current target “designated reserve ratio” (described in more detail below) of 2% for the DIF, and established a lower assessment rate schedule when the reserve ratio reaches 1.15% and, in lieu of dividends, provides for a lower assessment rate schedule when the reserve ratio reaches 2% and 2.5%.

An institution's assessment rate depends upon the institution's assigned risk category, which is based on supervisory evaluations, regulatory capital levels and certain other factors. Initial base assessment rates ranged from 2.5 to 45 basis points. The FDIC may make the following further adjustments to an institution's initial base assessment rates: decreases for long-term unsecured debt, including most senior unsecured debt and subordinated debt; increases for holding long-term unsecured debt or subordinated debt issued by other insured depository institutions; and increases for broker deposits in excess of 10% of domestic deposits for insurances not well rated and well capitalized. As of December 31, 2017, our risk category required a quarterly payment of approximately 8.52 basis points per \$100 of assessable deposits.

The Dodd-Frank Act transferred to the FDIC increased discretion with regard to managing the required amount of reserves for the DIF, or the “designated reserve ratio.” Among other changes, the Dodd-Frank Act (i) raised the minimum designated reserve ratio to 1.35 % and removed the upper limit on the designated reserve ratio, (ii) requires that the reserve ratio reach 1.35 % by September 2020, and (iii) requires the FDIC to offset the effect on institutions with total consolidated assets of less than \$10 billion of raising the reserve ratio from 1.15% to 1.35% which requirement was met by rules adopted by the FDIC during 2016. On June 30, 2016, the reserve ratio rose to 1.17%,

which triggered three major changes to deposit insurance assessments beginning for the third quarter of 2016: (i) the range of initial assessment rates for all institutions declined from 5 to 35 basis points to 3 to 30 basis points (which are included in the total base assessment rates in the above paragraph); (ii) surcharges equal to an annual rate of 4.5 basis points began for insured depository institutions with total consolidated assets of \$10 billion or more; and (iii) the revised assessment method described above was implemented. The FDIA requires that the FDIC consider the appropriate level for the designated reserve ratio on at least an annual basis. At June 30, 2017, the reserve ratio was 1.24%. The FDIC has adopted a DIF restoration plan to ensure that the fund reserve ratio reaches 1.35% by September 30, 2020, as required by the Dodd-Frank Act.

Allowance for Loan and Lease Losses

- 12 -

The Allowance for Loan and Lease Losses (the "ALLL") represents one of the most significant estimates in the Bank's financial statements and regulatory reports. Because of its significance, the Bank has established a system by which it develops, maintains, and documents a comprehensive, systematic, and consistently applied process for determining the amounts of the ALLL and the provision for loan and lease losses. The Interagency Policy Statement on the ALLL encourages all banks and federal savings institutions to ensure controls are in place to consistently determine the ALLL in accordance with generally accepted accounting principles in the United States, the federal savings association's stated policies and procedures, management's best judgment and relevant supervisory guidance. The Bank's estimate of credit losses reflects consideration of significant factors that affect the collectibility of the portfolio as of the evaluation date.

Safety and Soundness Standards

The Federal Deposit Insurance Act, as amended by the FDICIA and the Riegle Community Development and Regulatory Improvement Act of 1994, requires the federal bank regulatory agencies to prescribe standards, by regulations or guidelines, relating to internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, earnings, stock valuation and compensation, fees and benefits, and such other operational and managerial standards as the agencies deem appropriate. The federal bank regulatory agencies have adopted a set of guidelines prescribing safety and soundness standards pursuant to FDICIA, as amended. The guidelines establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation and fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director, or principal shareholder. In addition, the agencies adopted regulations that authorize, but do not require, an agency to order an institution that has been given notice by an agency that it is not satisfying any of such safety and soundness standards to submit a compliance plan. If, after being so notified, an institution fails to submit an acceptable compliance plan or fails in any material respect to implement an acceptable compliance plan, the agency must issue an order directing action to correct the deficiency and may issue an order directing other actions of the types to which an undercapitalized institution is subject under the "prompt corrective action" provisions of FDICIA. See "Prompt Corrective Action" above. If an institution fails to comply with such an order, the agency may seek to enforce such order in judicial proceedings and to impose civil money penalties. The federal regulatory agencies also proposed guidelines for asset quality and earnings standards.

Interagency Appraisal and Evaluation Guidelines

In December 2010, the federal banking agencies issued the Interagency Appraisal and Evaluation Guidelines. This guidance, which updated guidance originally issued in 1994, sets forth the minimum regulatory standards for appraisals. It incorporates previous regulatory issuances affecting appraisals, addresses advances in information technology used in collateral evaluation, and clarifies standards for use of analytical methods and technological tools in developing evaluations. This guidance also requires institutions to utilize strong internal controls to ensure reliable appraisals and evaluations and to monitor and periodically update valuations of collateral for existing real estate loans and transactions.

Community Reinvestment Act

Under the Community Reinvestment Act ("CRA"), the Bank has an obligation to help meet the credit needs of the entire community, including low- and moderate-income neighborhoods, consistent with safe and sound banking practices. The CRA requires the appropriate federal regulator, in connection with its examination of an insured institution, to assess the institution's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications, such as applications for a merger or the establishment of a branch. An unsatisfactory rating may be used as the basis for the denial of an application by the federal banking regulator.

The Bank received a satisfactory rating in its most recent CRA examination.

Restrictions on Transactions with Affiliates

We are subject to the provisions of Section 23A of the Federal Reserve Act. Section 23A places limits on: the amount of a bank's loans or extensions of credit to affiliates; a bank's investment in affiliates; assets a bank may purchase from affiliates, except for real and personal property exempted by the Federal Reserve; the amount of loans or extensions of credit to third parties collateralized by the securities or obligations of affiliates; and a bank's guarantee, acceptance or letter of credit issued on behalf of an affiliate.

The total permitted amount of the above transactions is limited in amount, as to any one affiliate, to 10.0% of a bank's capital and surplus and, as to all affiliates combined, to 20.0% of a bank's capital and surplus. In addition to the limitation on the amount

- 13 -

of these transactions, each of the above transactions must also meet specified collateral requirements. The Bank must also comply with other provisions designed to avoid the taking of low-quality assets.

We are also subject to the provisions of Section 23B of the Federal Reserve Act which, among other things, prohibit an institution from engaging in the above transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to the institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies.

The Dodd-Frank Act changed the definition of “covered transaction” in Sections 23A and 23B and limitations on asset purchases from insiders. With respect to the definition of “covered transaction,” the Dodd-Frank Act defines that term to include the acceptance of debt obligations issued by an affiliate as collateral for a bank’s loan or extension of credit to another person or company. In addition, a “derivative transaction” with an affiliate is now deemed to be a “covered transaction” to the extent that such a transaction causes a bank or its subsidiary to have a credit exposure to the affiliate. The Dodd-Frank Act also provides that the Bank may not “purchase an asset from, or sell an asset to” a Bank insider (or their related interests) unless (1) the transaction is conducted on market terms, and (2) if the proposed transaction represents more than 10% of the capital stock and surplus of the Bank, it has been approved in advance by a majority of the Bank’s non-interested directors.

The Bank is also subject to restrictions on extensions of credit to its executive officers, directors, principal stockholders and their related interests. These extensions of credit must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties, and must not involve more than the normal risk of repayment or present other unfavorable features.

Incentive Compensation

The Federal Reserve, the OCC and the FDIC have issued regulatory guidance (the “Incentive Compensation Guidance”) intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The Federal Reserve reviews, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Company, that are not “large, complex banking organizations.” The findings are included in reports of examination, and deficiencies are incorporated into the organization’s supervisory ratings. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

The Dodd-Frank Act requires the SEC and the federal bank regulatory agencies to establish joint regulations or guidelines that require financial institutions with assets of at least \$1 billion to disclose the structure of their incentive compensation practices and prohibit such institutions from maintaining compensation arrangements that encourage inappropriate risk-taking by providing excessive compensation, or that could lead to material financial loss to the financial institution. The SEC and federal bank regulatory agencies re-proposed regulations in 2016 (initially proposed in 2011) and previously issued guidance on sound incentive compensation policies, but have not yet finalized any regulations. If these or other regulations are adopted in a form similar to that initially proposed, they will impose limitations on the manner in which we may structure compensation for our executives. These proposed regulations incorporate the three principles discussed in the Incentive Compensation Guidance.

USA Patriot Act of 2001

In October 2001, the USA Patriot Act of 2001 (the “Patriot Act”) was enacted in response to the terrorist attacks in New York, Pennsylvania, and Washington, D.C. that occurred on September 11, 2001. The Patriot Act impacts financial institutions in particular through its anti-money laundering and financial transparency laws. The Patriot Act amended the Bank Secrecy Act and the rules and regulations of the Office of Foreign Assets Control to establish regulations

which, among others, set standards for identifying customers who open an account and promote cooperation with law enforcement agencies and regulators in order to effectively identify parties that may be associated with, or involved in, terrorist activities or money laundering.

Privacy

Financial institutions are required to disclose their policies for collecting and protecting confidential information. Customers generally may prevent financial institutions from sharing personal financial information with nonaffiliated third parties except for third parties that market the institutions' own products and services.

Additionally, financial institutions generally may not disclose consumer account numbers to any nonaffiliated third party for use in telemarketing, direct mail marketing or other marketing through electronic mail to consumers. The Bank has established

- 14 -

policies and procedures designed to safeguard its customers' personal financial information and to ensure compliance with applicable privacy laws.

Consumer Protection

The Dodd-Frank Act created the CFPB, a federal regulatory agency that is responsible for implementing, examining and enforcing compliance with federal consumer financial laws for institutions with more than \$10 billion of assets and, to a lesser extent, smaller institutions. The Dodd-Frank Act gives the CFPB authority to supervise and regulate providers of consumer financial products and services, establishes the CFPB's power to act against unfair, deceptive or abusive practices, and gives the CFPB rulemaking authority in connection with numerous federal consumer financial protection laws (for example, but not limited to, the Truth-in-Lending Act and the Real Estate Settlement Procedures Act).

As a smaller institution (i.e., with assets of \$10 billion or less), most consumer protection aspects of the Dodd-Frank Act will continue to be applied to the Company by the Federal Reserve and to the Bank by the OCC. However, the CFPB may include its own examiners in regulatory examinations by a smaller institution's prudential regulators and may require smaller institutions to comply with certain CFPB reporting requirements. In addition, regulatory positions taken by the CFPB and administrative and legal precedents established by CFPB enforcement activities, including in connection with supervision of larger bank holding companies, could influence how the Federal Reserve and OCC apply consumer protection laws and regulations to financial institutions that are not directly supervised by the CFPB. The precise impact of the CFPB's consumer protection activities cannot be forecasted.

Cybersecurity

The federal banking agencies have adopted guidelines for establishing information security standards and cybersecurity programs for implementing safeguards under the supervision of a financial institution's board of directors. These guidelines, along with related regulatory materials, increasingly focus on risk management and processes related to information technology and the use of third parties in the provision of financial products and services. The federal banking agencies expect financial institutions to establish lines of defense and to ensure that their risk management processes also address the risk posed by compromised customer credentials, and also expect financial institutions to maintain sufficient business continuity planning processes to ensure rapid recovery, resumption and maintenance of the institution's operations after a cyber attack. If the Company or the Bank fails to meet the expectations set forth in this regulatory guidance, the Company or the Bank could be subject to various regulatory actions and any remediation efforts may require significant resources of the Company or the Bank.

In October 2016, the federal banking agencies issued proposed rules on enhanced cybersecurity risk-management and resilience standards that would apply to very large financial institutions and to services provided by third parties to these institutions. The comment period for these proposed rules has closed and a final rule has not been published. Although the proposed rules would apply only to bank holding companies and banks with \$50 billion or more in total consolidated assets, these rules could influence the federal banking agencies' expectations and supervisory requirements for information security standards and cybersecurity programs of smaller financial institutions, such as the Company and the Bank.

Stress Testing

As required by the Dodd-Frank Act, the federal banking agencies have implemented stress testing requirements for certain financial institutions, including bank holding companies and state chartered banks, with more than \$10 billion in total consolidated assets. Although these requirements do not apply to institutions with less than \$10 billion in total consolidated assets, the federal banking agencies emphasize that all banking organizations, regardless of size, should have the capacity to analyze the potential impact of adverse market conditions or outcomes on the organization's financial condition. Based on existing regulatory guidance, the Company and the Bank will be expected to consider the institution's interest rate risk management, commercial real estate concentrations and other credit-related

information, and funding and liquidity management during this analysis of adverse outcomes.

Other Regulations

Interest and other charges collected or contracted for by the Bank are subject to federal laws concerning interest rates. The Bank's loan operations are also subject to federal laws applicable to credit transactions, such as the:

Federal Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
Home Mortgage Disclosure Act, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;

- 15 -

Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed, or other prohibited factors in extending credit;

- Fair Credit Reporting Act, governing the use and provision of information to credit reporting agencies; and

rules and regulations of the various federal agencies charged with the responsibility of implementing these federal laws.

The deposit operations of the Bank are subject to the following:

- the Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- the Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve to implement that act, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services; and
- the Truth in Savings Act, which requires disclosure of yields and costs of deposits and deposit accounts.

Effect of Governmental Monetary Policies

Our earnings are affected by the monetary and fiscal policies of the United States government and its agencies, as well as general domestic economic conditions. The Federal Reserve's power to implement national monetary policy has had, and is likely to continue to have, an important impact on the operating results of financial institutions. The Federal Reserve affects the levels of bank loans, investments, and deposits through its control over the issuance of U.S. government securities and through its regulation of the discount rate on borrowings of member banks and the reserve requirements against member bank deposits. It is difficult to predict the nature, timing or impact of future changes in monetary and fiscal policies.

Item 1A – Risk Factors

An investment in our stock involves a number of risks. Investors should carefully consider the following risks as well as the other information in this Report and the documents incorporated by reference before making an investment decision. The realization of any of the risks described below could have a material adverse effect on the Company and the price of our common stock.

Risks Relating to Our Business

Our industry and business may be adversely affected by conditions in the financial markets and economic conditions generally and in our market areas.

In recent years, we have faced periods of challenging and uncertain economic conditions, including a significant downturn in the oil and gas industry in our market areas. A return of recessionary conditions similar to 2008-2009 and/or a deterioration of national or local economic conditions could adversely affect the financial condition and operating performance of financial institutions. Specifically, declines in real estate values and sales volumes and increased unemployment levels may result in higher than expected loan delinquencies, increases in levels of non-performing and classified assets and a decline in demand for products and services offered by financial institutions. While general economic conditions in the markets in which we operate, as well as in the U.S. and worldwide, continued to improve during 2017, there can be no assurance that this improvement will continue. Uncertainty regarding continuing economic improvement may result in changes in consumer and business spending, borrowing and savings habits, which could cause us to incur losses and may adversely affect our results of operations and financial condition.

Our market areas are heavily dependent on, and we have significant credit exposure to, the oil and gas industry.

The economy in a large portion of our market areas is heavily dependent on the oil and gas industry. Many of our customers provide transportation and other services and products that support oil and gas exploration and production activities. We define an energy loan as any loan where the borrower's ability to repay is disproportionately impacted by a prolonged downturn in energy prices. Under this definition, the Bank includes direct Commercial and Industrial (C&I) loans to energy borrowers, as well as Commercial Real Estate loans, Residential Real Estate loans and loans to energy-related borrowers where the loan's primary collateral is cash and marketable securities. Although this definition has resulted in a lack of comparability with some other energy-related banks, management believes it to be the prudent approach to monitoring and managing the Bank's energy exposure. As of December 31, 2017, we had approximately \$179.7 million in loans to borrowers in the oil and gas industry, as defined above, representing approximately 15.2% of our total loans outstanding as of that date. The average loan size is approximately \$419,000, and the average loan size per relationship is roughly \$563,000. The oil and gas industry, especially in Louisiana and Texas, has been subject to significant volatility, including the "oil bust" of the 1980s that severely impacted

- 16 -

the economies of many of our market areas and, more recently, volatility in oil and gas prices and material declines in the level of drilling and production activity in Texas, Louisiana and other areas of the U.S. Decisions by certain members of the Organization of Petroleum Exporting Countries to maintain higher crude oil production levels have led to increased global oil supplies, which, when coupled with the continued exporting restrictions on the U.S. oil and gas industry and weaker global demand, has resulted in sustained low domestic market oil prices. Sustained low market oil prices have compressed margins for many U.S.-based oil producers, particularly those that utilize higher-cost production technologies such as hydraulic fracking and horizontal drilling, as well as oilfield service providers, energy equipment manufacturers and transportation suppliers, among others. These adverse developments in the oil and gas industry have had negative effects on the economies of our market areas in general, including adverse effects on commercial and residential real estate values and the general level of economic activity. If oil prices remain at these low levels for an extended period, the Bank could experience weaker oil and gas related loan demand and increased losses within its oil and gas loan portfolio. Furthermore, a prolonged period of low oil prices could also have a negative impact on the U.S. economy and, in particular, the economies of energy-dominant states such as Louisiana and Texas. Accordingly, if there is further deterioration in the oil and gas industry it could have a material adverse effect on our business, prospects, financial condition and results of operations.

We may suffer losses in our loan portfolio in excess of our allowance for loan losses.

We have experienced increases in the levels of our non-performing assets and loan charge-offs in recent periods. Our total non-performing assets amounted to \$57.3 million, or 3.04% of our total assets, at December 31, 2017, and we had \$27.7 million of net loan charge-offs and a \$30.2 million provision for loan losses for the year ended December 31, 2017. At December 31, 2017, the ratios of our ALLL to non-performing loans and to total loans outstanding were 53.77% and 2.27%, respectively. Additional increases in our non-performing assets or loan charge-offs could have a material adverse effect on our financial condition and results of operations.

We seek to mitigate the risks inherent in our loan portfolio by adhering to specific underwriting practices. These practices include analysis of a borrower's prior credit history, financial statements, tax returns and cash flow projections, valuation of collateral based on reports of independent appraisers and verification of liquid assets. Although we believe that our underwriting criteria are appropriate for the various kinds of loans we make, we still may incur losses on loans that meet our underwriting criteria, and these losses may exceed the amounts set aside as reserves in our ALLL. We create an ALLL in our accounting records, based on, among other considerations, the following:

- industry historical losses as reported by the FDIC;
- historical experience with our loans;
- evaluation of economic conditions;
- regular reviews of the quality mix, including our distribution of loans by risk grade within our portfolio, and size of our overall loan portfolio;
- regular reviews of delinquencies; and
- the quality of the collateral underlying our loans.

Although we maintain an ALLL at a level that we believe is adequate to absorb losses inherent in our loan portfolio, changes in economic, operating and other conditions, including conditions which are beyond our control such as a sharp decline in real estate values and changes in interest rates, may cause our actual loan losses to exceed our current allowance estimates. Additions to the ALLL could result in a decrease in net earnings and capital and could hinder our ability to grow. Further, if our actual loan losses exceed the amount reserved, it could have a material adverse effect on our financial condition and results of operations.

In June 2016, the FASB issued Accounting Standards Update (ASU) 2016-13, "Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," referred to as "CECL" (current expected credit

loss), which replaces the current incurred loss impairment methodology with a methodology that requires the measurement of all expected credit losses for financial assets not recorded at fair value based on historical experience, current conditions, and reasonable and supportable forecasts. The Company intends to adopt ASU 2016-13 during the first quarter of 2020, and adoption of this ASU could materially affect its allowance for loan losses methodology, financial condition, capital levels and results of operations, including expenses the Company may incur in implementing this ASU.

The Company and the Bank have both been placed in troubled condition by their respective federal banking regulators, which subjects us to significant restrictions and will require us to designate a significant amount of resources to comply. A failure to comply with restrictions imposed on financial institutions in troubled condition or with the terms of the written agreement to which the Bank is subject within the required timeframes could have a material adverse effect upon our business, financial condition and results of operations.

- 17 -

As discussed above in Item 1 under the heading “Business - Supervision and Regulation,” the Company and the Bank are both in “troubled condition” and the Bank has entered into a written agreement with the OCC. Because the Company is in troubled condition, the Company (1) must notify the Federal Reserve prior to adding or replacing a member of its board of directors or employing, or changing the responsibilities of any senior executive officer, and (2) may not, except under certain circumstances, enter into any agreements to make severance or indemnification payments or make any such payments to “institution-affiliated parties” as defined in the regulations. The Bank is subject to similar restrictions due to its troubled condition status. Under the written agreement, the Bank is also required to take certain immediate and continuing actions related to problem assets and lending practices, among other remedial actions.

If the Company or the Bank is not successful in complying with their respective regulatory restrictions, or the Bank does not comply with the written agreement within the required time frames, we could become subject to additional enforcement actions, sanctions or restrictions on our business activities. While subject to regulatory actions and restrictions, we expect that our management and Board of Directors will be required to focus considerable time and attention on taking corrective actions. We have also hired third party consultants and advisors to assist us, which will increase our non-interest expense and reduce our earnings. The Bank has appointed a committee to monitor compliance with the written agreement and is working to promptly address the requirements of the written agreement. There is no guarantee, however, that the Bank will successfully address the OCC’s concerns in the written agreement or that we will be able to comply with it. If we do not comply with the written agreement, we could be subject to civil monetary penalties, further regulatory sanctions and/or other enforcement actions.

We may become subject to additional enforcement actions that could have a material negative effect on our business, operations, financial condition, results of operations or the value of our common stock. Federal and state regulators have the ability to impose substantial sanctions, restrictions and requirements on our banking subsidiaries if they determine, upon examination or otherwise, violations of laws, rules or regulations with which we or our subsidiaries must comply, or weaknesses or failures with respect to general standards of safety and soundness. Such enforcement may be formal or informal and can include directors’ resolutions, memoranda of understanding, consent orders, written agreements, civil money penalties and termination of deposit insurance and bank closures. Enforcement actions may be taken regardless of the capital level of the institution. In particular, institutions that are not sufficiently capitalized in accordance with regulatory standards may also face capital directives or prompt corrective action. Enforcement actions may impose restrictions on the payment of dividends or severance payments, require certain corrective steps (including staff additions or changes), impose limits on activities (such as lending, deposit taking, ability to accept brokered-deposits or branching), prescribe lending parameters (such as loan types, volumes and terms), require the disposition of certain assets and liabilities, require additional capital to be raised or expenses to be incurred or prevent us from conducting any expansionary activities, including acquisitions. The imposition of any additional enforcement actions or regulatory sanctions or monetary penalties could have a material negative effect on our business, operations, financial condition, results of operations or the value of our common stock.

We may be unable to successfully implement and manage our recently announced strategic initiatives, which could result in the failure to achieve the anticipated cost savings and materially impair our profitability and financial condition.

We recently began the implementation of a number of strategic initiatives to address the regulatory concerns and market challenges and to improve the overall profitability and financial condition of the Company and the Bank. There can be no assurances that these strategic initiatives will be successful in addressing these concerns and challenges, and if we are not successful in implementing and managing these strategic initiatives our profitability and financial condition could be materially impaired in future periods. We may also incur expenses in connection with these strategic initiatives beyond our current estimates, which may result in additional losses to us and the costs of these strategic initiatives outweighing any benefits resulting therefrom. Furthermore, if these strategic initiatives do not adequately address regulatory concerns, we could become subject to additional regulatory actions, including

enforcement actions as described in the preceding risk factors.

Loss of key officers or employees, or failure to successfully transition our management, could materially and adversely affect our business and operating results and may disrupt relationships with certain customers.

As a community bank, our business is primarily relationship-driven in that many of our key employees have extensive customer relationships. In addition, our success has been and will continue to be greatly influenced by the ability to retain senior management and, with expansion, to attract and retain qualified additional senior and middle management. We recently replaced our President and Chief Executive Officer and have also appointed other new executive officers. Our future success will depend, to a significant extent, on the ability of our new management team to operate effectively, both individually and as a group. We must successfully manage issues that may result from the transition of the new members of our executive management. Loss of a key employee with such customer relationships may lead to the loss of business if the customers were to follow that employee to a competitor. While we believe our relationships with our key personnel are good, we cannot guarantee that all of our key personnel will

- 18 -

remain with our organization. Loss of such key personnel, should they enter into an employment relationship with one of our competitors, could result in the loss of some of our customers.

We cannot predict the effect of recent or future legislative and regulatory initiatives.

Financial institutions have been the subject of substantial legislative and regulatory changes and may be the subject of further legislation or regulation in the future, including: (i) changes in banking, securities and tax laws and regulations and their application by our regulators, including pursuant to the Dodd-Frank Act, as discussed above in Item 1 under the heading “Business – Supervision and Regulation”; and (ii) changes in the scope and cost of FDIC insurance and other coverage, none of which is within our control. Significant new laws or regulations or changes in, or repeals of, existing laws or regulations may cause our results of operations to differ materially from those we currently anticipate. In addition, the cost and burden of compliance with applicable laws and regulations have significantly increased and could adversely affect our ability to operate profitably. Further, federal monetary policy significantly affects credit conditions for us, as well as for our borrowers, particularly as implemented by the Federal Reserve Board, primarily through open market operations in U.S. government securities, the discount rate for bank borrowings and reserve requirements. A material change in any of these conditions could have a material impact on us or our borrowers, and therefore on our business, prospects, financial condition and results of operations.

The short-term and long-term impact of the changing regulatory capital requirements is uncertain.

Effective January 1, 2015, the Basel III Capital Rules that substantially changed the regulatory risk-based capital rules applicable to the Company and the Bank began to phase in. The Basel III Capital Rules include new minimum risk-based capital and leverage ratios and modify the capital and asset definitions for purposes of calculating those ratios. Among other things, as of January 1, 2015, the Basel III Capital Rules established a new common equity Tier 1 minimum capital requirement of 4.5%, a higher minimum Tier 1 capital to risk-weighted assets requirement of 6.0% and a higher total capital to risk-weighted assets of 8.0%. In addition, the Basel III Capital Rules provide, to be considered “well-capitalized,” a new common equity Tier 1 capital requirement of 6.5% and a higher Tier 1 capital to risk-weighted assets requirement of 8.0% that are effective as of January 1, 2015. Moreover, the Basel III Capital Rules limit a banking organization’s capital distributions and certain discretionary bonus payments if the banking organization does not hold a “capital conservation buffer” consisting of an additional 2.5% of common equity Tier 1 capital in addition to the 4.5% minimum common equity Tier 1 requirement and the other amounts necessary to the minimum risk-based capital requirements that is being phased in beginning in 2016 and fully effective in 2019.

The application of the more stringent capital requirements described above could, among other things, result in lower returns on invested capital, require the raising of additional capital, and result in additional regulatory actions if we were to be unable to comply with such requirements. Furthermore, the imposition of liquidity requirements under the Basel III Capital Rules could result in our having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets. Implementation of changes to asset risk weightings for risk-based capital calculations, items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could result in us modifying our business strategy and could limit our ability to pay dividends.

We have a concentration of exposure to a number of individual borrowers. Given the size of these loan relationships relative to capital levels and earnings, a significant loss on any one of these loans could materially and adversely affect us.

We have a concentration of exposure to a number of individual borrowers. Our largest exposure to one borrowing relationship as of December 31, 2017, was approximately \$12.3 million, which is 4.9% of our total capital. In addition, as of December 31, 2017, the aggregate exposure to the ten largest borrowing relationships was approximately \$110.6 million, which was 9.4% of loans and 43.5% of total capital. As a result of this concentration, a change in the financial condition of one or more of these borrowers could result in significant loan losses and have a material adverse effect on our financial condition and results of operations.

A significant percentage of our deposits are attributable to a relatively small number of customers. The loss of all or some of these customers or a significant decline in their deposit balances may have a material adverse effect on our liquidity and results of operations.

As of December 31, 2017, our 20 largest depositors accounted for approximately 10.3% of total deposits, of which our top five depositors accounted for approximately 5.1% of total deposits. The ability to attract these types of deposits has a positive effect on our net interest margin as they provide a relatively low cost of funds to the Bank. While we believe we have strong, long-term relationships with each of these customers, the loss of one or more of our 20 largest deposit customers, or a significant decline in the deposit balances would adversely affect our liquidity and require us to attract new deposits, purchase federal funds or borrow funds on a short-term basis to replace such deposits, possibly at interest rates higher than those currently paid on such deposits. This could increase our total cost of funds and could result in a decrease in our net interest income and net earnings.

- 19 -

If we were unable to develop alternative funding sources, we may have difficulty funding loans or meeting other deposit withdrawal requirements.

We occasionally purchase non-recourse loan participations from other banks based in part on information provided by the selling bank.

From time to time, we purchase loan participations from other banks in the ordinary course of business, usually without recourse to the selling bank. As of December 31, 2017, we had approximately \$56.7 million in purchased loan participations, or approximately 4.7% of our total loan portfolio. When we purchase loan participations, we apply the same underwriting standards as we would to loans that we directly originate and seek to purchase only loans that would satisfy these standards. However, we are not as familiar with the borrower and may rely on information provided to us by the selling bank and typically must rely on the selling bank's administration of the loan relationship. We therefore have less control over, and may incur more risk with respect to, loan participations that we purchase from selling banks as compared to loans that we originate.

Our focus on lending to small to mid-sized community-based businesses may increase our credit risk.

Most of our commercial business and commercial real estate loans are made to small business or middle market customers. These businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities and have a heightened vulnerability to economic conditions. If general economic conditions in the markets in which we operate negatively impact this important customer sector, our results of operations and financial condition and the value of our common stock may be adversely affected. Moreover, a portion of these loans have been made by us in recent years and the borrowers may not have experienced a complete business or economic cycle. Furthermore, the deterioration of our borrowers' businesses may hinder their ability to repay their loans with us, which could have a material adverse effect on our financial condition and results of operations.

Our loan portfolio includes a substantial percentage of commercial and industrial loans, which may be subject to greater risks than those related to residential loans.

Our loan portfolio includes a substantial percentage of commercial and industrial loans. Commercial and industrial loans generally carry larger loan balances and historically have involved a greater degree of financial and credit risks than residential first mortgage loans. Repayment of our commercial and industrial loans is often dependent on cash flow of the borrower, which may be unpredictable, and collateral securing these loans may fluctuate in value. Our commercial and industrial loans are primarily made based on the cash flow of the borrower and, secondarily, on the underlying collateral provided by the borrower. Most often, this collateral consists of accounts receivable, inventory, equipment, or real estate. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. Other collateral securing loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. At December 31, 2017, commercial and industrial loans totaled approximately 36.8% of our total loan portfolio. Adverse changes in local economic conditions impacting our business borrowers could have a material adverse effect on our business, prospects, financial condition and results of operations.

We have a high concentration of loans secured by real estate, and an adverse change in the real estate market could have a material effect on our financial condition and results of operations.

A significant portion of our loan portfolio is dependent on real estate. At December 31, 2017, approximately 57.9% of our loans had real estate as a primary or secondary component of collateral. The collateral in each case provides an alternate source of repayment if the borrower defaults and may deteriorate in value during the time the credit is extended. An adverse change in the economy affecting values of real estate in our primary markets could significantly impair the value of real estate collateral and the ability to sell real estate collateral upon foreclosure. Furthermore, it is likely that we would be required to increase the provision for loan losses. A related risk in connection with loans secured by real estate is the effect of unknown or unexpected environmental contamination, which could make the real

estate effectively unmarketable or otherwise significantly reduce its value as collateral. If we were required to liquidate real estate collateral securing a loan to satisfy the debt during a period of reduced real estate values or to increase the allowance for loan losses, it could have a material adverse effect on our financial condition and results of operations.

We are subject to environmental liability risk associated with our lending activities.

A significant portion of the Bank's loan portfolio is secured by real property. During the ordinary course of business, the Bank may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property's value or limit the Bank's ability to use or sell the affected property. In addition, future laws or

- 20 -

more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

Our future earnings could be adversely affected by non-cash charges for goodwill impairment, if a future test of goodwill indicates that goodwill has been impaired.

As prescribed by Accounting Standards Codification (“ASC”) Topic 350, “Intangibles — Goodwill and Other,” we undertake an annual review of the goodwill asset balance reflected in our financial statements. We conduct an annual review in the fourth quarter of each year, unless there has been a triggering event prescribed by applicable accounting rules that warrants an earlier interim testing for possible goodwill impairment. After our most recent annual review in the fourth quarter of 2017, we concluded there was no goodwill impairment as of such date. As of December 31, 2017, we had \$42.2 million in goodwill. Future goodwill impairment tests may result in future non-cash charges, which could adversely affect our earnings for any such future period.

Changes in the fair value of our securities may reduce our stockholders’ equity and net income.

At December 31, 2017, \$309.2 million of our securities (at fair value) were classified as available-for-sale. At such date, the aggregate net unrealized loss on our available-for-sale securities was \$3.4 million. We increase or decrease stockholders’ equity by the amount of change from the unrealized gain or loss (the difference between the estimated fair value and the amortized cost) of our available-for-sale securities portfolio, net of the related tax, under the category of accumulated other comprehensive income/loss. Therefore, a decline in the estimated fair value of this portfolio will result in a decline in reported stockholders’ equity, as well as book value per common share and tangible book value per common share. This decrease will occur even though the securities are not sold. In the case of debt securities, if these securities are never sold and there are no credit impairments, the decrease will be recovered over the life of the securities. In the case of equity securities which have no stated maturity, the declines in fair value may or may not be recovered over time.

We monitor the fair value of our entire securities portfolio as part of our ongoing other than temporary impairment (“OTTI”) evaluation process. No assurance can be given that we will not need to recognize OTTI charges related to securities in the future. In addition, as a condition to membership in the Federal Home Loan Bank of Dallas (“FHLB-Dallas”), we are required to purchase and hold a certain amount of FHLB-Dallas stock. Our stock purchase requirement is based, in part, upon the outstanding principal balance of advances from the FHLB-Dallas. At December 31, 2017, we had stock in the FHLB-Dallas totaling approximately \$3.5 million. The FHLB-Dallas stock held by us is carried at cost and is subject to recoverability testing under applicable accounting standards. For the year ended December 31, 2017, we did not recognize an impairment charge related to our FHLB-Dallas stock holdings. There can be no assurance, however, that future negative changes to the financial condition of the FHLB-Dallas may not require us to recognize an impairment charge with respect to such holdings.

The CFPB may reshape the consumer financial laws through rulemaking and enforcement of the prohibitions against unfair, deceptive and abusive business practices, which may directly impact the business operations of depository institutions offering consumer financial products or services, including the Bank.

The CFPB has broad rulemaking authority to administer and carry out the provisions of the Dodd-Frank Act with respect to financial institutions that offer to consumers covered financial products and services. The CFPB has also been directed to write rules identifying practices or acts 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 concept of what may be considered to be an “abusive” practice is new under the law. While the Bank will not be supervised by the CFPB, it will still be subject to the regulations and policies promulgated by the CFPB and may be examined by the OCC for compliance therewith. The costs and limitations related to complying with any new regulations established by the CFPB have yet to be fully determined and could be material. Further, the limitations and restrictions that will be placed upon the Bank with respect to its consumer product offerings and

services may also produce significant, material effects on the Bank's (and our) profitability.

A natural disaster, especially one affecting one of our market areas, could adversely affect us. Since most of our business is conducted in Louisiana and Texas, most of our credit exposure is in those states. Historically, Louisiana and Texas have been vulnerable to natural disasters. Therefore, we are susceptible to the risks of natural disasters, such as hurricanes, floods and tornadoes. Natural disasters could harm our operations directly through interference with communications, including the interruption or loss of our websites, which would prevent us from gathering deposits, originating loans and processing and controlling our flow of business, as well as through the destruction of facilities and our operational, financial and management information systems. A natural disaster or recurring power outages may also impair the value of our largest class of assets, our loan portfolio, as uninsured or underinsured losses, including losses from business disruption, may reduce borrowers' ability to repay their loans. Disasters may also reduce the value of the real estate securing our loans, impairing our ability to recover on defaulted loans through foreclosure and making it more likely that we would suffer losses on defaulted

- 21 -

loans. Although we have implemented several back-up systems and protections (and maintain business interruption insurance), these measures may not protect us fully from the effects of a natural disaster. The occurrence of natural disasters in our market areas could have a material adverse effect on our business, prospects, financial condition and results of operations.

Our profitability is vulnerable to interest rate fluctuations.

Our profitability is dependent to a large extent on net interest income, which is the difference between our interest income on interest-earning assets, such as loans and investment securities, and interest expense on interest-bearing liabilities, such as deposits and borrowings. When interest-bearing liabilities mature or reprice more quickly than interest-earning assets in a given period, a significant increase in market rates of interest could adversely affect net interest income. Conversely, when interest-earning assets mature or reprice more quickly than interest-bearing liabilities, falling interest rates could result in a decrease in net interest income. Furthermore, some of our variable interest rate loans have minimum fixed interest rates (“floors”) that are currently above the contractual variable interest rate. If interest rates rise, the interest income from our variable interest rate loans with floors may not increase as quickly as interest expense on our liabilities, which would negatively impact our net interest income.

The banking industry has experienced a prolonged period of unusually low interest rates. The Federal Reserve began raising rates in late 2015 and their benchmark rate and market rates increased during 2016 and 2017. Although financial markets generally expect the Federal Reserve to raise its benchmark rate multiple times during 2018, there is substantial uncertainty regarding the extent to which interest rates may increase in 2018 and future periods and what the future effects of any such increases will be. There is no assurance that recent expectations of increasing interest rates in future periods will be realized.

In periods of increasing interest rates, loan originations may decline, depending on the performance of the overall economy, which may adversely affect income from lending activities and rates paid on deposits and borrowings may reprice before rates earned on loans or investment securities. Also, increases in interest rates could adversely affect the market value of fixed income assets. In addition, an increase in the general level of interest rates may affect the ability of certain borrowers to pay the interest and principal on their obligations.

Non-performing assets take significant time to resolve and adversely affect our results of operations and financial condition.

Non-performing assets adversely affect our net earnings in various ways. We generally do not record interest income on non-performing loans or other real estate owned, thereby adversely affecting our earnings, and increasing our loan administration costs. When we take collateral in foreclosures and similar proceedings, we mark the related asset to the then fair market value of the collateral less estimated selling costs, which may result in a loss. An increase in the level of non-performing assets increases our risk profile and may impact the capital levels our regulators believe are appropriate in light of the ensuing risk profile. While we reduce problem assets through loan sales, workouts, restructurings and otherwise, decreases in the value of the underlying collateral, or in these borrowers’ performance or financial condition, whether or not due to economic and market conditions beyond our control, could adversely affect our business, results of operations and financial condition. In addition, the resolution of non-performing assets, including taking actions required by the Bank's written agreement with the OCC, requires significant commitments of time from management and our directors, which can be detrimental to the performance of their other responsibilities. We may also hire third party consultants and advisors to assist us, which would increase our non-interest expense and reduce our earnings. There can be no assurance that we will not experience future increases in non-performing assets.

The soundness of other financial institutions could adversely affect us.

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 we 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 the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to us. Any such losses could have a material adverse effect on our business, prospects, financial condition and results of operations.

We operate within a highly regulated environment and our business and results are affected by the regulations to which we are subject.

We operate within a highly regulated environment. The regulations to which we are subject will continue to have an impact on our operations and the degree to which we can grow and be profitable. Certain regulators, to which we are subject, have significant power in reviewing our operations and approving our business practices. In recent years the Bank, as well as other financial institutions, has experienced increased regulation and regulatory scrutiny, often requiring additional resources. In addition, investigations or proceedings brought by regulatory agencies may result in judgments, settlements, fines, penalties, or other

- 22 -

results adverse to us. There is no assurance that any change to the regulatory requirements to which we are subject, or the way in which such regulatory requirements are interpreted or enforced, will not have a negative effect on our ability to conduct our business and our results of operations.

Our operations may be adversely affected by cybersecurity risks.

In the ordinary course of business, we collect and store sensitive data, including proprietary business information and personally identifiable information of our customers and employees in systems and on networks. The secure processing, maintenance, and use of this information is critical to our operations and business strategy. In addition, we rely heavily on communications and information systems to conduct our business. Any failure, interruption, or breach in security or operational integrity of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan, and other systems. We have invested in accepted technologies, and continually review processes and practices that are designed to protect its networks, computers, and data from damage or unauthorized access. Despite these security measures, our computer systems and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance, or other disruptions. A breach of any kind could compromise systems and the information stored there could be accessed, damaged, or disclosed. A breach in security or other failure could result in legal claims, regulatory penalties, disruption in operations, increased expenses, loss of customers and business partners, and damage to our reputation, which could adversely affect our business and financial condition. Furthermore, as cyber threats continue to evolve and increase, we may be required to expend significant additional financial and operational resources to modify or enhance its protective measures, or to investigate and remediate any identified information security vulnerabilities.

We rely heavily on technology and computer systems. The negative effects of computer system failures and unethical individuals with the technological ability to cause disruption of service could adversely affect our reputation and our ability to generate deposits.

Our ability to compete depends on our ability to continue to adapt and deliver technology on a timely and cost-effective basis to meet customers' demands for financial services. We provide our customers the ability to bank online and many customers now remotely submit deposits to us through remote-capture systems. The secure transmission of confidential information over the Internet is a critical element of these services. Our network could be vulnerable to unauthorized access, computer viruses, phishing schemes and other security problems. We may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses. To the extent that our activities or the activities of our customers involve the storage and transmission of confidential information, security breaches and viruses could expose us to claims, litigation and other possible liabilities. Any inability to prevent security breaches or computer viruses could also cause existing customers to lose confidence in our systems and could adversely affect our reputation and our ability to generate deposits.

We rely on third parties to provide key components of our business infrastructure.

Third parties provide key components of our business operations such as data processing, recording and monitoring transactions, online banking interfaces and services, Internet connections and network access. While we have selected these third party vendors carefully, we do not control their actions. Any problems caused by these third parties, including those resulting from disruptions in communication services provided by a vendor, failure of a vendor to handle current or higher volumes, cyber-attacks and security breaches at a vendor, failure of a vendor to provide services for any reason or poor performance of services, could adversely affect our ability to deliver products and services to our customers and otherwise conduct our business. Financial or operational difficulties of a third party vendor could also hurt our operations if those difficulties interfere with the vendor's ability to serve us. Furthermore, our vendors could also be sources of operational and information security risk to us, including from breakdowns or failures of their own systems or capacity constraints. Replacing these third party vendors could also create significant delay and expense. Accordingly, use of such third parties creates an unavoidable inherent risk to our business operations.

Consumers may decide not to use banks to complete their financial transactions.

Technology and other changes are allowing parties to complete financial transactions through alternative methods that historically have involved banks. For example, consumers can now maintain funds that would have historically been held as bank deposits in brokerage accounts, mutual funds or general-purpose reloadable prepaid cards. Consumers can also complete transactions such as paying bills and/or transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries, known as “disintermediation,” could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost of deposits as a source of funds could have a material adverse effect on our financial condition and results of operations.

Risks Relating to an Investment in Our Common Stock

- 23 -

Our future ability to pay dividends and repurchase stock is subject to restrictions and we may be unable to pay future dividends even if we desire to do so.

Holders of our common stock are only entitled to receive such cash dividends as our board of directors may declare out of funds legally available for such payments. Although we have historically declared cash dividends on our common stock, we are not required to do so and may reduce or eliminate our common stock cash dividend in the future. This could adversely affect the market price of our common stock. Since we are a holding company, we have no material source of income other than dividends received from the Bank. Although we had \$50.2 million of cash at December 31, 2017, historically, our ability to pay dividends to our shareholders has depended on the Bank's ability to pay dividends to us. Moreover, banks and bank holding companies are both subject to certain federal and state regulatory restrictions on cash dividends. We are also restricted from paying dividends if we have deferred payments of the interest on, or an event of default has occurred with respect to, our trust preferred securities, Series B Preferred Stock or Series C Preferred Stock. Additionally, terms and conditions of our outstanding shares of preferred stock place certain restrictions and limitations on our common stock dividends and repurchases of our common stock.

The holders of our preferred stock and trust preferred securities have rights that are senior to those of stockholders and that may impact our ability to pay dividends on our common stock and net income available to our common stockholders.

At December 31, 2017, we had outstanding \$22.2 million of trust preferred securities. These securities are senior to shares of common stock. As a result, we must make payments on our trust preferred securities before any dividends can be paid on our common stock. Moreover, in the event of our bankruptcy, dissolution, or liquidation, the obligations outstanding with respect to our trust preferred securities must be satisfied before any distributions can be made to our stockholders. While we have the right to defer dividends on the trust preferred securities for a period of up to five years, if any such election is made, no dividends may be paid to our common or preferred stockholders during that time.

In addition, with respect to the \$32.0 million in Series B Preferred Stock outstanding that was issued to the Treasury in the SBLF transaction, we are required to pay cumulative dividends on the Series B Preferred Stock at an annual rate. The dividend rate was set at 1.00% beginning in the fourth quarter of 2013 due to attaining the target 10% growth rate in qualified small business loans during the second quarter of 2013. Beginning February 25, 2016, the dividend rate increased to 9% per annum. The \$9.0 million in Series C Preferred Stock currently outstanding that was originally issued in connection with the PSB acquisition calls for the non-cumulative payment of dividends at an annual rate of 4.0%. Dividends paid on our Series B Preferred Stock or Series C Preferred Stock will also reduce the net income available to our common stockholders and our earnings per common share. We may not declare or pay dividends on our common stock or repurchase shares of our common stock without first having paid all accrued preferred dividends that are due.

Share ownership may be diluted by the issuance of additional shares of common stock in the future.

Our stock incentive plan provides for the granting of stock incentives to directors, officers, and employees. As of December 31, 2017, there were 188,275 shares issued under options. Likewise, approximately 182,288 shares may be issued in the future to directors, officers, and employees under our existing equity incentive plans. In addition, in 2009, as part of our participation in the Treasury's Capital Purchase Program ("CPP"), we issued a stock purchase warrant that currently entitles the holder to purchase 104,384 shares of our common stock at an exercise price of \$14.37 per share. It is probable that options and/or warrants will be exercised during their respective terms if the stock price exceeds the exercise price of the particular option or warrant. The incentive plan also provides that all issued options automatically and fully vest upon a change in control. If the options are exercised, share ownership will be diluted.

Additionally, share ownership of our common stock will be diluted from shares issued upon conversion of the Series C Preferred Stock issued in the PSB acquisition. As of December 31, 2017, there were 89,875 shares of Series C Preferred Stock issued and outstanding. Holders may convert the Series C Preferred Stock at any time into shares of the Company's common stock at a conversion price of \$18.00 per share, subject to customary antidilution adjustments. In addition, the Company currently has the option to require conversion of the Series C Preferred Stock if the closing price of the Company's common stock for 20 trading days within any period of 30 consecutive trading days, exceeds 130% of the conversion price.

In addition, our articles of incorporation authorize the issuance of up to 30,000,000 shares of common stock and 5,000,000 shares of preferred stock, but do not provide for preemptive rights to the stockholders; therefore, stockholders will not automatically have the right to subscribe for additional shares. As a result, if we issue additional shares to raise additional capital or for other corporate purposes, you may be unable to maintain your pro rata ownership in the Company.

Only a limited trading market exists for our common stock, which could lead to price volatility.

- 24 -

Our common stock is listed for trading on the NYSE under the trading symbol “MSL,” but there is low trading volume in our common stock. The limited trading market for our common stock may cause fluctuations in the market value of our common stock to be exaggerated, leading to price volatility in excess of that which might occur in a more active trading market of our common stock. Future sales of substantial amounts of common stock in the public market, or the perception that such sales may occur, could adversely affect the prevailing market price of our common stock. In addition, even if a more active market in our common stock develops, we cannot assure you that such a market will continue.

Our directors and executive management own a significant number of shares of stock, allowing further control over business and corporate affairs.

Our directors and executive officers beneficially own approximately 1.9 million shares, or 11.5%, of our outstanding common stock as of December 31, 2017. As a result, in addition to their day-to-day management roles, they will be able to exercise significant influence on our business as stockholders, including influence over election of the Board and the authorization of other corporate actions requiring shareholder approval. In deciding on how to vote on certain proposals, our stockholders should be aware that our directors and executive officers may have interests that are different from, or in addition to, the interests of our stockholders generally.

Provisions of our articles of incorporation and by-laws, Louisiana law, and state and federal banking regulations could delay or prevent a takeover by a third party.

Our articles of incorporation and by-laws could delay, defer, or prevent a third party takeover, despite possible benefit to the stockholders, or otherwise adversely affect the price of our common stock. Our governing documents:

- permit directors to be removed by stockholders only for cause and only upon an 80% vote;
- require 80% of the voting power for stockholders to amend the by-laws, call a special meeting, or amend the articles of incorporation, in each case if the proposed action was not approved by the Board;
- authorize a class of preferred stock that may be issued in series with terms, including voting rights, established by the Board without stockholder approval;
- authorize approximately 30 million shares of common stock and 5 million shares of preferred stock that may be issued by the Board without shareholder approval;
- classify our Board with staggered three year terms, preventing a change in a majority of the Board at any annual meeting;
- require advance notice of proposed nominations for election to the Board and business to be conducted at a shareholder meeting; and
- require 80% of the voting power for stockholders to approve business combinations not approved by the Board.

These provisions would likely preclude a third party from removing incumbent directors and simultaneously gaining control of the Board by filling the vacancies thus created with its own nominees. Under the classified Board provisions, it would take at least two elections of directors for any individual or group to gain control of the Board. Accordingly, these provisions could discourage a third party from initiating a proxy contest, making a tender offer or otherwise attempting to gain control. These provisions may have the effect of delaying consideration of a shareholder proposal until the next annual meeting unless a special meeting is called by the Board or the chairman of the Board. Moreover, even in the absence of an attempted takeover, the provisions make it difficult for stockholders dissatisfied with the Board to effect a change in the Board’s composition, even at annual meetings.

A shareholder’s investment is not an insured deposit.

An investment in our common stock is not a bank deposit and is not insured or guaranteed by the FDIC or any other government agency. Your investment in our common stock will be subject to investment risk and you may lose all or part of your investment.

Item 1B – Unresolved Staff Comments

None.

Item 2 - Properties

We lease our principal executive and administrative offices and principal facility in Lafayette, Louisiana under a lease expiring July 31, 2021. In addition to our principal facility, we also have seven other branches located in Lafayette, Louisiana, two in New Iberia, Louisiana, four in Baton Rouge, Louisiana, three in Natchitoches, Louisiana, two in Lake Charles, Louisiana, and one branch in each of the following Louisiana cities: Breaux Bridge, Cecilia, Houma, St. Martinville, Opelousas, Carencro,

- 25 -

Morgan City, Jennings, Sulphur, Thibodaux, Robeline, Toledo Bend, Greenwood, Zwolle, Many and Mansfield. We also have an operations office in Breaux Bridge, Louisiana. Twenty-nine of these offices are owned and seven are leased.

Additionally, in our Texas market area we have two full service branches located in Beaumont, Texas. Our additional full service branches in the Texas market area are located in Houston, Vidor, Conroe, Magnolia, College Station, Plano, Mesquite, Rockwall, Greenville, Tyler and Texarkana. Of these offices, eleven are owned and two are leased.

Item 3 - Legal Proceedings

The Bank has been named as a defendant in various other legal actions arising from normal business activities in which damages of various amounts are claimed. While the amount, if any, of ultimate liability with respect to such matters cannot be currently determined, management believes, after consulting with legal counsel, that any such liability will not have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows. However, in the event of unexpected future developments in these matters, if the ultimate resolution of any such matter is unfavorable, the result may be material to the Company's consolidated financial position, consolidated results of operations or consolidated cash flows.

Item 4 – Mine Safety Disclosures

Not applicable.

- 26 -

Executive Officers of the Registrant

The names, ages as of December 31, 2017, and positions of our current executive officers are listed below along with their business experience during the past five years.

James R. McLemore, 58 – President and Chief Executive Officer of the Company and the Bank since May 2017. Mr. McLemore previously served as the Company’s Interim President and Chief Executive Officer since April 2017 and Chief Financial Officer since July 2009. Prior to joining the Company, Mr. McLemore served as Executive Vice President and Chief Financial Officer of Security Bank Corporation from 2002 until July 2009. In July 2009, subsequent to Mr. McLemore’s departure, the six subsidiary banks of Security Bank Corporation were closed and the FDIC was appointed receiver of the banks. Security Bank Corporation subsequently filed for bankruptcy in August of 2009. Mr. McLemore has also been a member of the Board of Directors of the Company and the Bank since June 2017.

Erin DeWitt, 39 – Senior Executive Vice President and Chief Risk Officer of the Company and the Bank since May 2017. Ms. DeWitt previously had been serving as Chief Risk Officer of the Bank since April 2017. Prior to joining the Company, Ms. DeWitt served as Chief Risk Officer for Scottrade Financial Services for two years. Ms. DeWitt served in various risk related roles at Capital One over seven years prior to joining Scottrade. Ms. DeWitt was also an examiner with the Federal Reserve System from 2000-2004.

Lorraine Miller, 54 – Executive Vice President and Chief Financial Officer of the Company and the Bank since May 2017. Ms. Miller previously served as the Senior Vice President, Director of Mergers and Acquisitions of the Company and the Bank since February 2010, and the Treasurer of the Company and the Bank since January 2013. Prior to joining the Company, Ms. Miller served as Senior Vice President in Finance and Investor Relations roles with Security Bank Corporation and WestPoint Home and as a Senior Equity Research Analyst at SunTrust Equitable Securities and The Robinson-Humphrey Company, Inc. over a span of 23 years.

Clay Abington, 51 – Executive Vice President Corporate Efficiency of the Company and the Bank since May 2017. Mr. Abington previously served as Senior Vice President Business Process Manager of the Bank since December 2012. Prior to joining the Company, Mr. Abington served in various capacities for PSB Financial, Inc., including Senior Vice President and Chief Risk Officer. Mr Abington is the son of Mr. Leonard Q. “Pete” Abington, a member of the Company’s board of directors.

All executive officers are appointed for one year terms expiring at the first meeting of the Board of Directors after the annual stockholders meeting next succeeding his or her election and until his or her successor is elected and qualified.

PART II

Item 5 - Market for Registrant's Common Equity, Related Shareholder Matters, and Issuer Purchases of Equity Securities

As of February 28, 2018, there were 897 common stockholders of record. The Company's common stock trades on the NYSE under the symbol "MSL." The high and low sales price for the past eight quarters has been provided in the Selected Quarterly Financial Data tables that are included with this filing under Item 8 and is incorporated herein by reference.

Cash dividends totaling \$2.8 million were declared to common stockholders during 2017. The regular quarterly dividend of \$0.09 per share was paid for the first and second quarters of 2017. The regular quarterly dividend was decreased to \$0.01 per share for the third and fourth quarters of 2017, for a total of \$0.20 per share for the year. Cash dividends totaling \$4.1 million were declared to common stockholders during 2016. The regular quarterly dividend of \$0.09 per share was paid for all four quarters of 2016, for a total of \$0.36 per share for the year.

The amount of future dividends, if any, will be determined by our board of directors and will depend on our earnings, financial condition and other factors considered by the board of directors to be relevant. In addition, the payment of cash dividends on our common stock will depend upon the ability of the Bank to declare and pay dividends to the Company. The Bank's ability to pay dividends will depend primarily upon its earnings, financial condition, and need for funds, as well as applicable governmental policies. Even if we have earnings in an amount sufficient to pay dividends, the Bank's board of directors may determine to retain earnings for the purpose of funding growth.

There are various legal limitations with respect to the Bank's ability to pay dividends to the Company and the Company's ability to pay dividends to shareholders. Under the Louisiana law, we may not pay a dividend if (i) after giving it effect, either of the following conditions would exist (A) the Company would not be able to pay its debts as they become due in the usual course of business, or (B) the Company's total assets would be less than the sum of its total liabilities plus, unless the articles of incorporation permit otherwise, the amount that would be needed, if the Company were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the dividend; or (ii) the declaration or payment thereof would be contrary to any restrictions contained in our articles of incorporation. Under federal banking law, the prior approval of the Federal Reserve Board and the OCC may be required in certain circumstances prior to the payment of dividends by us or the Bank. A national bank may generally declare a dividend, without approval from the OCC, in an amount equal to its year-to-date net income plus the prior two years' net income that is still available for dividend. The OCC has the authority to prohibit a national bank from paying dividends if such payment is deemed to be an unsafe or unsound practice. Due to the loss reported for the year ended December 31, 2017, the Bank does not have the ability to approve dividends to the Company without prior approval from the OCC. In addition, as a depository institution the deposits of which are insured by the FDIC, the Bank may not pay dividends or distribute any of its capital assets while it remains in default on any assessment due to the FDIC. The Bank currently is not in default under any of its obligations to the FDIC.

The Federal Reserve Board has issued a policy statement regarding the payment of dividends by bank holding companies. In general, the Federal Reserve Board's policy provides that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the bank holding company appears consistent with the organization's capital needs, asset quality and overall financial condition. The Federal Reserve Board has the authority to prohibit us from paying dividends if such payment is deemed to be an unsafe or unsound practice.

In addition, pursuant to the terms of our Series B Preferred Stock, Series C Preferred Stock, and the terms of our trust preferred securities, we are prohibited from paying dividends on our common stock during any period in which we

have deferred interest payments on either the Series B Preferred Stock, Series C Preferred Stock or the trust preferred securities.

- 28 -

The following graph compares the cumulative total return on our common stock over a period beginning December 31, 2012 with (1) the cumulative total return on the stocks included in the Russell 3000 and (2) the cumulative total return on the stocks included in the SNL Securities, LC (“SNL”) \$1B - \$5B Bank Index. The comparison assumes an investment in our common stock on the indices of \$100 at December 31, 2012 and assumes that all dividends were reinvested during the applicable period.

MidSouth Bancorp, Inc.

Index	Period Ending					
	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017
MidSouth Bancorp, Inc.	100.00	111.40	110.25	59.40	92.16	91.55
Russell 3000	100.00	133.55	150.32	151.04	170.28	206.26
SNL Bank \$1B-\$5B	100.00	145.41	152.04	170.20	244.85	261.04

The stock price information shown above is based on historical data and should not be considered indicative of future price performance.

Item 6 – Five Year Summary of Selected Financial Data

	At and For the Year Ended December 31,					
	2017	2016	2015	2014	2013	
	(dollars in thousands, except per share data)					
Interest income	\$80,623	\$78,030	\$81,897	\$83,487	\$83,203	
Interest expense	(6,026)	(5,690)	(5,581)	(5,807)	(6,539)	
Net interest income	74,597	72,340	76,316	77,680	76,664	
Provision for loan losses	(30,200)	(10,600)	(13,900)	(5,625)	(3,050)	
Noninterest income	21,781	20,106	20,321	24,422	19,319	
Noninterest expenses	(80,537)	(68,550)	(67,137)	(70,009)	(72,606)	
(Loss) earnings before income taxes	(14,359)	13,296	15,600	26,468	20,327	
Income tax benefit (expense)	2,598	(3,857)	(4,583)	(7,358)	(6,151)	
Net (loss) earnings	\$(11,761)	\$9,439	\$11,017	\$19,110	\$14,176	
Dividends on preferred stock	(3,242)	(2,861)	(687)	(698)	(1,332)	
Net (loss) earnings available to common stockholders	\$(15,003)	\$6,578	\$10,330	\$18,412	\$12,844	
Basic (loss) earnings per common share	\$(1.06)	\$0.58	\$0.91	\$1.63	\$1.14	
Diluted (loss) earnings per common share	\$(1.06)	\$0.58	\$0.90	\$1.58	\$1.12	
Dividends per common share	\$0.20	\$0.36	\$0.36	\$0.35	\$0.31	
Total loans	\$1,183,426	\$1,284,082	\$1,263,645	\$1,284,431	\$1,137,554	
Total assets	1,881,152	1,943,340	1,927,733	1,936,740	1,851,160	
Total deposits	1,479,689	1,579,430	1,550,850	1,585,234	1,518,803	
Long-term obligations	32,188	47,591	48,018	48,444	57,087	
Selected ratios:						
Loans to assets	62.91	% 66.08	% 65.55	% 66.32	% 61.45	%
Loans to deposits	79.98	% 81.30	% 81.48	% 81.02	% 74.90	%
Deposits to assets	78.66	% 81.27	% 80.45	% 81.85	% 82.05	%
Return on average assets	(0.78)	% 0.34	% 0.53	% 0.97	% 0.69	%
Return on average common equity	(7.32)	% 3.73	% 6.00	% 11.43	% 8.64	%

Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations

The purpose of this discussion and analysis is to highlight changes in the financial condition of the Company and on its results of operations during 2017, 2016 and 2015. This discussion and analysis is intended to highlight and supplement information presented elsewhere in this annual report on Form 10-K, particularly the consolidated financial statements and related notes appearing in Item 8.

Overview

We are a bank holding company, headquartered in Lafayette, Louisiana, that through our community banking subsidiary, MidSouth Bank, N.A., operates 48 offices in Louisiana and Texas. We had approximately \$1.9 billion in consolidated assets as of December 31, 2017. We derive the majority of our income from interest received on our loans and investments. Our primary source of funds for making these loans and investments is our deposits, on which we pay interest. Approximately 71.8% of our total deposits are interest-bearing. Consequently, one of the key measures of our success is our amount of net interest income, or the difference between the income on our interest-earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, such as

deposits and borrowings. The resulting ratio of that difference as a percentage of our average earning assets represents our net interest margin. Another key measure is the spread between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities, which is called our net interest spread. In addition to earning

- 30 -

interest on our loans and investments, we earn income through fees and other charges to our customers. We have also included a discussion of the various components of this noninterest income, as well as of our noninterest expense.

There are risks inherent in all loans, so we maintain an allowance for loan losses to absorb probable losses on existing loans that may become uncollectible. We maintain this allowance by charging a provision for loan losses against our operating earnings for each period. We have included a detailed discussion of this process, as well as several tables describing our allowance for loan losses.

The economy in a large portion of our market areas is heavily dependent on the oil and gas industry. Over the past several years, we have experienced sustained low oil and gas prices that has led to an increase in our classified assets. While most of our customers are not directly involved in oil and gas exploration, many of our customers provide transportation and other services and products that support oil and gas exploration and production activities and are therefore indirectly impacted by low commodity prices. In addition, these adverse developments in the oil and gas industry have had negative effects on the economies of our market areas in general, including adverse effects on commercial and residential real estate values and the general level of economic activity. The oil and gas industry, especially in Louisiana and Texas, has historically been subject to significant volatility, and these market areas have experienced a slower recovery from this current economic cycle which has adversely impacted the Bank's customers and their ability to recover from this downturn. As of December 31, 2017, we had approximately \$179.7 million in loans to borrowers in the oil and gas industry representing approximately 15.2% of our total loans outstanding as of that date, which represents a reduction of \$57.7 of these types of loans, or 24%, since December 31, 2016, and we continue to make efforts to reduce our concentrations in these loans.

The Company and the Bank have both been placed in troubled condition by their respective federal banking regulators. The Bank has also entered into a written agreement with the OCC. These designations and the written agreement subject us to significant restrictions and will require us to designate a significant amount of resources to comply. See Part I, Item 1 under the heading "Business - Supervision and Regulation - Troubled Condition and Written Agreement" for additional information.

The following discussion and analysis also identifies significant factors that have affected our financial position and operating results during the periods included in the financial statements accompanying or incorporated by reference in this report. We encourage you to read this discussion and analysis in conjunction with our consolidated financial statements and the notes thereto and other statistical information included and incorporated by reference in this annual report on Form 10-K.

Critical Accounting Policies

Certain critical accounting policies affect the more significant judgments and estimates used in the preparation of the consolidated financial statements. Our significant accounting policies are described in the notes to the consolidated financial statements included in this report. The accounting principles we follow and the methods of applying these principles conform to accounting principles generally accepted in the United States of America ("GAAP") and general banking practices. Our most critical accounting policy relates to the determination of the allowance for loan losses, which reflects the estimated losses resulting from the inability of its borrowers to make loan payments. The determination of the adequacy of the allowance involves significant judgment and complexity and is based on many factors. If the financial condition of our borrowers were to deteriorate, resulting in an impairment of their ability to make payments, the estimates would be updated and additional provisions for loan losses may be required. See Asset Quality – Allowance for Loan Losses and Note 1 and Note 3 of the notes to the consolidated financial statements.

Another of our critical accounting policies relates to the valuation of goodwill, intangible assets and other purchase accounting adjustments. We account for acquisitions in accordance with ASC Topic No. 805, which requires the use

of the purchase method of accounting. Under this method, we are required to record assets acquired and liabilities assumed at their fair value, including intangible assets. Determination of fair value involves estimates based on internal valuations of discounted cash flow analyses performed, third party valuations, or other valuation techniques that involve subjective assumptions. Additionally, the term of the useful lives and appropriate amortization periods of intangible assets is subjective. Resulting goodwill from an acquisition under the purchase method of accounting represents the excess of the purchase price over the fair value of net assets acquired. Goodwill is not amortized, but is evaluated for impairment annually or more frequently if deemed necessary. If the fair value of an asset exceeds the carrying amount of the asset, no charge to goodwill is made. If the carrying amount exceeds the fair value of the asset, goodwill will be adjusted through a charge to earnings. In evaluating the goodwill on our consolidated balance sheet for impairment at December 31, 2017, we first assessed qualitative factors to determine whether it is more likely than not that the fair value of our acquired assets is less than the carrying amount of the acquired assets, as allowed under ASU 2011-08, Intangibles- Goodwill and Other (Topic 350): Testing Goodwill for Impairment. After making the assessment based on several

- 31 -

factors, which included but was not limited to the current economic environment, the economic outlook in our markets, our financial performance and common stock value as compared to our peers, we determined it is more likely than not that the fair value of our acquired assets is greater than the carrying amount and, accordingly, no impairment of goodwill was recorded for the year ended December 31, 2017.

Given the instability of the economic environment, it is reasonably possible that the methodology of the assessment of potential loan losses and goodwill impairment could change in the near-term or could result in impairment going forward.

Another of our critical accounting policies relates to deferred tax assets and liabilities. We record deferred tax assets and deferred tax liabilities for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax benefits, such as net operating loss carry forwards, are recognized to the extent that realization of such benefits is more likely than not. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which the assets and liabilities are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period that includes the enactment date. In the event the future tax consequences of differences between the financial reporting bases and the tax bases of our assets and liabilities results in deferred tax assets, an evaluation of the probability of being able to realize the future benefits indicated by such assets is required. A valuation allowance is provided when it is more likely than not that a portion or the full amount of the deferred tax asset will not be realized. In assessing the ability to realize the deferred tax assets, management considers the scheduled reversals of deferred tax liabilities, projected future taxable income, and tax planning strategies. A deferred tax liability is not recognized for portions of the allowance for loan losses for income tax purposes in excess of the financial statement balance. Such a deferred tax liability will only be recognized when it becomes apparent that those temporary differences will reverse in the foreseeable future. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50 percent more likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The 2017 Tax Cuts and Jobs Act (the "Tax Act") enacted on December 22, 2017 resulted in the Company applying a new lower federal income tax rate (21%) to the Company's deferred tax assets and liabilities recorded as of December 31, 2017. The Company recorded a \$3.6 million adjustment to income tax expense to revalue its deferred tax assets and liabilities at the new income tax rate.

Results of Operations

Net loss available to common stockholders for the year ended December 31, 2017 totaled \$15.0 million compared to net earnings available to common shareholders of \$6.6 million for the year ended December 31, 2016. A loss of \$1.06 per diluted share was reported for the year ended December 31, 2017, compared to diluted earnings per common share of \$0.58 for 2016. The 2017 net loss included \$347,000 of gain on sales of securities, \$744,000 of gain on sale of branches, \$1.5 million of severance and retention accruals, \$465,000 of one-time charges related to discontinued branch projects, \$903,000 of one-time charges related to the closure of branches, a \$1.4 million write-down of assets held for sale, a \$6.0 million loss on transfer of loans to held for sale, \$2.6 million of regulatory remediation costs and a \$3.6 million write-down of our net deferred tax asset resulting from the Tax Cuts and Jobs Act. Excluding these non-operating items, net loss available to common shareholders decreased \$10.3 million in year-over-year comparison. A \$19.6 million increase in provision for loan losses and a \$381,000 increase in dividends on preferred stock were partially offset by a \$2.8 million increase in operating revenues, a \$910,000 decrease in noninterest expenses and a \$5.9 million decrease in income tax expense.

Total consolidated assets remained constant at \$1.9 billion for the years ended December 31, 2017 and December 31, 2016. Deposits totaled \$1.5 billion at December 31, 2017 compared to \$1.6 billion at December 31, 2016. Our stable

core deposit base, which excludes time deposits, totaled \$1.3 billion at December 31, 2017 and accounted for 87.7% of deposits at December 31, 2017 compared to 90.4% of deposits at year end 2016. Time deposits increased \$30.1 million for the year ended December 31, 2017. Net loans decreased \$103.2 million, or 8.2%, for the year ended December 31, 2017 and totaled \$1.2 billion at December 31, 2017.

Our Tier 1 leverage capital ratio was 12.53% at December 31, 2017 compared to 10.11% at December 31, 2016. Tier 1 risk-weighted capital and total risk-weighted capital ratios were 16.51% and 17.77% at December 31, 2017, compared to 13.02% and 14.28% at December 31, 2016, respectively. Our Tier 1 common equity ratio at December 31, 2017 was 12.10%, compared to 8.81% at December 31, 2016. The changes in regulatory capital levels are primarily attributable to the 5,100,034 shares of common stock issued in connection with the capital raise during the second quarter of 2017 that resulted in net proceeds to the Company of \$57.2 million. Return on average common equity was -7.32% for 2017 compared to 3.73% for 2016. Return on average assets was -0.78% compared to 0.34% for the same periods, respectively.

- 32 -

Nonperforming assets totaled \$57.3 million at December 31, 2017, a decrease of \$7.7 million over the \$65.0 million reported for year-end 2016. The decrease resulted from a \$12.8 million decrease in nonperforming loans, which was partially offset by a \$5.1 million increase in nonperforming loans held for sale. Nonaccrual loans totaled \$49.3 million at December 31, 2017 compared to \$62.6 million at December 31, 2016. Loans past due 90 days or more and still accruing interest totaled \$728,000 at December 31, 2017 compared to \$268,000 at December 31, 2016. Total nonperforming assets to total assets were 3.04% at December 31, 2017 compared to 3.35% at December 31, 2016. Loans classified as troubled debt restructurings (“TDRs”) totaled \$9.9 million at December 31, 2017 compared to \$25.3 million at December 31, 2016. These totals included \$8.6 million and \$25.1 million, respectively, of loans reported in nonaccrual loans.

Allowance coverage for nonperforming loans was 53.77% at December 31, 2017 compared to 38.78% at December 31, 2016. Year-to-date net charge-offs were 2.21% of average total loans as of December 31, 2017 compared to 0.41% as of December 31, 2016. The ALL/total loans ratio increased to 2.27% for the year ended December 31, 2017 compared to 1.90% at December 31, 2016.

Table 1

Summary of Return on Equity and Assets

	2017	2016	2015
Return on average assets	(0.78)%	0.34 %	0.53 %
Return on average common equity	(7.32)%	3.73 %	6.00 %
Dividend payout ratio on common stock	(18.87)%	62.07%	40.00%
Average equity to average assets	12.75 %	11.25%	10.91%

NOTE: 2017 return on average assets and return on average common equity were impacted by a \$347,000 gain on sales of securities, a \$744,000 gain on sale of branches, \$1.5 million of severance and retention accruals, \$465,000 of one-time charges related to discontinued branch projects, \$903,000 of one-time charges related to the closure of branches, a \$1.4 million write-down of assets held for sale, a \$6.0 million loss on transfer of loans to held for sale, \$2.6 million of regulatory remediation costs and a \$3.6 million write-down of our net deferred tax asset resulting from the Tax Cuts and Jobs Act. Excluding these non-operating items, return on average assets for the year ended December 31, 2017 was -0.19% and return on average common equity for the year ended December 31, 2017 was -1.82%. 2015 return on average assets and return on average common equity were impacted by a \$1.2 million net gain on sale of securities and \$160,000 in income from a death benefit on bank owned life insurance. Excluding these non-operating items, return on average assets for the year ended December 31, 2015 was 0.48% and return on average common equity for the year ended December 31, 2015 was 5.44%.

Earnings Analysis

Net Interest Income

Our primary source of earnings is net interest income, which is the difference between interest earned on loans and investments and interest paid on deposits and other interest-bearing liabilities. Changes in the volume and mix of earning assets and interest-bearing liabilities combined with changes in market rates of interest greatly affect net interest income. Our net interest margin on a taxable equivalent basis, which is net interest income as a percentage of average earning assets, was 4.25%, 4.14%, and 4.28% for the years ended December 31, 2017, 2016, and 2015, respectively. Tables 2 and 3 analyze the changes in net interest income for the years ended December 31, 2017, 2016, and 2015.

Table 2
Consolidated Average Balances, Interest, and Rates
(in thousands)

	Year Ended December 31, 2017			2016			2015		
	Average Volume	Interest	Average Yield/ Rate	Average Volume	Interest	Average Yield/ Rate	Average Volume	Interest	Average Yield/ Rate
Assets									
Investment securities¹									
Taxable	\$372,523	\$9,180	2.46 %	\$352,865	\$7,924	2.25 %	\$340,428	\$7,559	2.22 %
Tax exempt ²	56,569	2,283	4.04 %	63,260	2,680	4.24 %	74,836	3,342	4.47 %
Total investment securities	429,092	11,463	2.67 %	416,125	10,604	2.55 %	415,264	10,901	2.63 %
Federal funds sold	3,979	43	1.06 %	3,364	16	0.47 %	3,578	8	0.22 %
Time and interest bearing deposits in other banks	71,754	854	1.17 %	76,328	399	0.51 %	62,659	164	0.26 %
Other investments	11,790	340	2.88 %	11,254	351	3.12 %	10,471	345	3.29 %
Loans									
Commercial and real estate	1,192,448	64,294	5.39 %	1,175,900	61,628	5.24 %	1,185,788	63,637	5.37 %
Installment	63,040	4,414	7.00 %	87,825	5,956	6.78 %	106,064	6,837	6.45 %
Total loans ³	1,255,488	68,708	5.47 %	1,263,725	67,584	5.35 %	1,291,852	70,474	5.46 %
Total earning assets	1,772,103	81,408	4.59 %	1,770,796	78,954	4.46 %	1,783,824	81,892	4.59 %
Allowance for loan losses	(23,966)			(20,823)			(15,127)		
Nonearning assets	181,401			185,252			188,520		
Total assets	\$1,929,538			\$1,935,225			\$1,957,217		
Liabilities and stockholders' equity									
NOW, money market, and savings	\$952,238	\$3,000	0.32 %	\$1,014,772	\$2,913	0.29 %	\$943,615	\$2,214	0.23 %
Time deposits	168,766	1,099	0.65 %	161,926	741	0.46 %	226,188	1,373	0.61 %
Total interest-bearing deposits	1,121,004	4,099	0.37 %	1,176,698	3,654	0.31 %	1,169,803	3,587	0.31 %
Securities sold under agreements to repurchase	78,347	685	0.87 %	88,618	943	1.06 %	84,622	961	1.14 %
Federal funds purchased	—	—	— %	1	—	— %	1	—	— %
Short-term FHLB advances	6,301	77	1.20 %	5,669	23	0.40 %	27,959	56	0.20 %
Long-term FHLB advances	24,390	335	1.37 %	25,633	366	1.40 %	26,059	364	1.38 %
Junior subordinated debentures	22,167	830	3.69 %	22,167	704	3.12 %	22,167	613	2.73 %
	1,252,209	6,026	0.48 %	1,318,786	5,690	0.43 %	1,330,611	5,581	0.42 %

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Total interest-bearing liabilities			
Demand deposits	423,954	390,585	405,571
Other liabilities	7,372	8,214	7,576
Stockholders' equity	246,003	217,640	213,459
Total liabilities and stockholders' equity	\$1,929,538	\$1,935,225	\$1,957,217
Net interest income and net interest spread ⁴	\$75,382 4.11 %	\$73,264 4.03 %	\$76,311 4.17 %
Net interest margin	4.25 %	4.14 %	4.28 %

¹ Securities classified as available-for-sale are included in average balances and interest income figures and reflect interest earned on such securities.

² Interest income of \$785,000 for 2017, \$924,000 for 2016, and \$1,154,000 for 2015 is added to interest earned on tax-exempt obligations to reflect tax-equivalent yields using a tax rate of 35%.

³ Interest income includes loan fees of \$3,879,000 for 2017, \$4,932,000 for 2016, and \$5,170,000 for 2015. Nonaccrual loans are included in average balances and income on such loans is recognized on a cash basis.

⁴ Net interest income includes accretion income of \$1,393,000 for 2017, \$1,857,000 for 2016, and \$2,342,000 for 2015.

Table 3
Changes in Taxable-Equivalent Net Interest Income
(in thousands)

	2017 Compared to 2016			2016 Compared to 2015		
	Total Increase (Decrease)	Change in Volume	Change in Rates	Total Increase (Decrease)	Change in Volume	Change in Rates
Taxable-equivalent interest earned on:						
Investment securities						
Taxable	\$1,256	\$420	\$836	\$365	\$278	\$87
Tax-exempt	(397)	(301)	(96)	(662)	(497)	(165)
Federal funds sold	27	4	23	8	—	8
Time and interest-bearing deposits in other banks	455	(25)	480	235	42	193
Other investments	(11)	14	(25)	6	25	(19)
Loans, including fees	1,124	(443)	1,567	(2,890)	(1,638)	(1,252)
Total	2,454	(331)	2,785	(2,938)	(1,790)	(1,148)
Interest paid on:						
Interest-bearing deposits	445	(180)	625	67	18	49
Securities sold under agreements to repurchase	(258)	(102)	(156)	(18)	43	(61)
Short-term FHLB advances	54	3	51	(33)	(65)	32
Long-term FHLB advances	(31)	(15)	(16)	2	(3)	5
Junior subordinated debentures	126	—	126	91	—	91
Total	336	(294)	630	109	(7)	116
Taxable-equivalent net interest income	\$2,118	\$(37)	\$2,155	\$(3,047)	\$(1,783)	\$(1,264)

NOTE: Changes due to both volume and rate have generally been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts to the changes in each.

In year-over-year comparison, FTE net interest income increased \$2.1 million primarily due to a \$1.1 million increase in interest income on loans and an \$859,000 increase in FTE interest income from investment securities. The average volume of investment securities increased \$13.0 million in year-over-year comparison, and the average yield on investment securities increased 12 basis points for the same period. The average volume of loans decreased \$8.2 million in year-over-year comparison, and the average yield on loans increased 12 basis points, from 5.35% to 5.47%. The average yield on earning assets increased 13 basis points in year-over-year comparison, from 4.46% at December 31, 2016 to 4.59% at December 31, 2017. Purchase accounting adjustments added 9 basis points to the average yield on loans for the year ended December 31, 2017 and 13 basis points for the year ended December 31, 2016. Net of purchase accounting adjustments, the average yield on earning assets increased 16 basis points, from 4.37% at December 31, 2016 to 4.53% at December 31, 2017. Interest expense increased \$336,000 in year-over-year comparison. Increases in interest expense included a \$445,000 increase in interest expense on deposits and a \$126,000 increase in interest expense on junior subordinated debentures. These increases were partially offset by a \$258,000 decrease in interest expense on repurchase agreements. The average rate paid on interest-bearing liabilities was 0.48% for the year ended December 31, 2017, compared to 0.43% for the year ended December 31, 2016. Purchase accounting adjustments added 3 basis points to the average rate paid on interest-bearing liabilities for the year ended December 31, 2017 and 2016. The FTE net interest margin increased 11 basis points, from 4.14% for the year ended December 31, 2016 to 4.25% for the year ended December 31, 2017. Net of purchase accounting adjustments, the FTE net interest margin increased 14 basis points, from 4.03% to 4.17% for the years ended December 31, 2016 and 2017, respectively.

FTE net interest income decreased \$3.0 million from 2015 to 2016 primarily due to a \$2.9 million decrease in interest income on loans. The average volume of loans decreased \$28.1 million in year-over-year comparison, and the average yield on loans decreased 11 basis points, from 5.46% to 5.35%. The average volume of investment securities increased \$861,000 in year-over-year comparison, and the average yield on investment securities decreased 8 basis points for the same period. The average yield on earning assets decreased in year-over-year comparison, from 4.59% at December 31, 2015 to 4.46% at December 31, 2016.

- 35 -

Purchase accounting adjustments added 12 basis points to the average yield on loans for the year ended December 31, 2016 and 17 basis points for the year ended December 31, 2015. Excluding purchase accounting adjustments, the average yield on earning assets decreased 10 basis points, from 4.47% at December 31, 2015 to 4.37% at December 31, 2016. Interest expense increased \$109,000 in year-over-year comparison. Increases in interest expense included a \$67,000 increase in interest expense on deposits and a \$91,000 increase in interest expense on junior subordinated debentures. These increases were partially offset by a \$33,000 decrease in interest expense on short-term FHLB advances and a \$18,000 decrease in interest expense on securities sold under agreements to repurchase. The average rate paid on interest-bearing liabilities was 0.43% for the year ended December 31, 2016, compared to 0.42% for the year ended December 31, 2015. Purchase accounting adjustments added 3 basis points to the average rate paid on interest-bearing liabilities for the year ended December 31, 2016 and 2015. The FTE net interest margin decreased 8 basis points, from 4.28% for the year ended December 31, 2015 to 4.20% for the year ended December 31, 2016. Excluding purchase accounting adjustments, the FTE net interest margin decreased 11 basis points, from 4.14% to 4.03% for the years ended December 31, 2015 and 2016, respectively, primarily due to a decline in the average rate earned on loans and the decreased average volume of loans.

Noninterest Income

Noninterest income totaled \$21.8 million at December 31, 2017 compared to \$20.1 million at December 31, 2016 and \$21.5 million at December 31, 2015. Our recurring non-interest income includes service charges and fees on deposit accounts, ATM and debit card income and mortgage lending income.

Table 4 presents noninterest income for the years ended December 31, 2017, 2016 and 2015.

Table 4

Noninterest Income (in thousands)

	Year Ended December 31,		
	2017	2016	2015
Service charges on deposit accounts	\$9,724	\$9,883	\$9,754
ATM and debit card income	6,912	6,579	6,463
Mortgage lending	627	586	618
Increase in cash value of life insurance	261	315	331
Credit card interchange and merchant-related income	1,543	1,437	1,540
Letter of credit income	6	26	80
Gain on securities, net (non-operating)	347	20	1,243
Gain on sale of branches (non-operating)	744	—	—
Income from death benefit on BOLI (non-operating)	—	—	160
Other	1,617	1,260	1,291
Total noninterest income	\$21,781	\$20,106	\$21,480

Income from service charges and fees on deposit accounts, including insufficient funds fees (“NSF” fees), decreased \$159,000 in 2017 and increased \$129,000 in 2016. ATM and debit card income increased \$333,000 in 2017 and \$116,000 in 2016. The increase in ATM and debit card income during 2017 and 2016 was a result of an increase in electronic transactions processed. Other noninterest income increased \$357,000 in 2017 and decreased \$31,000 in 2016. The increase in 2017 was primarily due to a \$231,000 increase in gain on sale of loans as well as a \$178,000 increase in check cashing income.

Noninterest Expense

Noninterest expense totaled \$80.5 million for the year ended December 31, 2017 compared to \$68.6 million and \$67.1 million for the years ended December 31, 2016 and 2015, respectively. Our recurring non-interest expense consists of

salaries and employee benefits, occupancy expense, ATM and debit card expense and other operating expenses.

Table 5 presents noninterest expense for the years ended December 31, 2017, 2016 and 2015.

- 36 -

Table 5
Noninterest Expense
(in thousands)

	Year Ended December 31,		
	2017	2016	2015
Salaries and employee benefits	\$32,377	\$32,932	\$32,036
Occupancy expense	13,851	14,630	15,052
ATM and debit card	2,721	3,239	2,951
Legal and professional fees	3,319	1,855	1,560
FDIC premiums	1,572	1,601	1,513
Marketing	1,197	1,523	1,564
Corporate development	1,016	1,572	1,531
Data processing	2,640	1,963	1,888
Printing and supplies	509	760	923
Expenses on ORE, net	517	389	267
Amortization of core deposit intangibles	1,106	1,107	1,106
Severance and retention accruals (non-operating)	1,512	—	—
One-time charge related to discontinued branch projects (non-operating)	465	—	—
One-time charge related to closure of branches (non-operating)	903	—	—
Write-down of assets held for sale (non-operating)	1,359	—	—
Loss on transfer of loans to held for sale (non-operating)	6,030	—	—
Regulatory remediation costs (non-operating)	2,628	—	—
Other	6,815	6,979	6,746
Total noninterest expense	\$80,537	\$68,550	\$67,137

Total noninterest expense increased 17.5%, or \$12.0 million, from 2016 to 2017 and increased 2.1%, or \$1.4 million, from 2015 to 2016. Nonoperating expenses in 2017 totaled \$12.9 million and consisted of \$1.5 million of severance and retention accruals, \$465,000 of one-time charges related to discontinued branch projects, \$903,000 of one-time charges related to the closure of branches, a \$1.4 million write-down of assets held for sale, a \$6.0 million loss on transfer of loans to held for sale and \$2.6 million of regulatory remediation costs.

Excluding non-operating expenses, salaries and employee benefits decreased \$555,000, or 1.7%, in 2017. The number of employees on a full-time equivalent ("FTE") basis decreased by 68 during 2017, from 535 at year end 2016 to 467 at year end 2017, which is primarily attributable to the closure and sale of 9 branches during 2017. Salaries and employee benefits increased \$896,000, or 2.8%, in 2016. The number of employees on a FTE basis decreased by one during 2016, from 536 at year end 2015 to 535 at year end 2016. The increase in salaries and benefits costs during 2016 was partially due to \$143,000 of sign-on bonuses related to recruiting new talent to the organization, including new producers in Texas and a new Chief Information Officer. Also contributing to the increase in salaries and employee benefits costs during 2016 was \$223,000 of severance benefits accrued and a \$349,000 increase in group health costs.

Excluding non-operating expenses, occupancy expenses decreased \$779,000 in 2017 and decreased \$422,000 in 2016. The decrease in 2017 was primarily due to the closure and sale of 9 branches during 2017. The decrease in 2016 was primarily the result of lower lease expense and lower depreciation expense. Premises and equipment additions and leasehold improvements totaled approximately \$3.8 million, \$5.8 million and \$5.4 million for the years 2017, 2016, and 2015, respectively.

ATM and debit card processing fees decreased \$518,000 in 2017 and was primarily driven by a \$315,000 decrease in losses on ATM/debit card processing. ATM and debit card processing fees increased \$288,000 in 2016 and was

primarily driven by a \$231,000 increase in losses on ATM/debit card processing. Losses on ATM/debit card processing for the year ended December 31, 2015 included a \$55,000 insurance reimbursement for losses sustained in 2014. Excluding this insurance reimbursement, losses on ATM/debit card processing increased \$176,000 in 2016.

- 37 -

Excluding non-operating expenses, legal and professional fees increased \$1.5 million in 2017 and increased \$295,000 in 2016. The increase in 2017 was due to a \$904,000 increase in legal fees and a \$541,000 increase in outsourcing costs. The increase in legal fees is primarily due to the elevated level of non-performing loans. The increase in outsourcing costs is primarily due to costs related to internal audit services. The increase in 2016 was due to a \$127,000 increase in legal fees, an \$86,000 increase in consulting fees and an \$85,000 increase in outsourcing costs. The increase in legal fees during 2016 was primarily due to our elevated levels of non-performing loans.

A reclassification of certain hosted services subscriptions from corporate development into data processing at the beginning of 2017 caused the fluctuations in those two expense categories during 2017.

During 2017, we had \$12.9 million of non-operating noninterest expenses, including \$1.5 million of severance and retention accruals, \$465,000 of one-time charges related to discontinued branch projects, \$903,000 of one-time charges related to the closure of branches, a \$1.4 million write-down of assets held for sale, a \$6.0 million loss on transfer of loans to held for sale and \$2.6 million of regulatory remediation costs. Of the \$1.5 million of severance and retention accruals, \$1.0 million was the accrual of severance benefits resulting from the termination of an executive pursuant to an employment agreement. The remaining \$475,000 of severance and retention accruals were recorded in connection with the closure and sale of branches that occurred during 2017. Also recorded as a result of the closure of branches were \$903,000 of other charges, including lease termination costs and write-offs of leasehold improvements and furniture and equipment, and \$1.4 million in write-downs on those branches that were owned and moved to held for sale. During the fourth quarter of 2017, we transferred approximately \$15.7 million of loans to held for sale and recorded a \$6.0 million loss to write those loans down to fair value. The \$2.6 million of regulatory remediation costs incurred during 2017 were consulting and outsourcing costs for assistance in complying with terms of our regulatory written agreement.

Other noninterest expense decreased \$268,000 in 2017 and included decreases of \$159,000 in recruiting expense and \$180,000 in directors' fees. The decreased expenses were partially offset by increases of \$226,000 in appraisal fees and \$320,000 in provision for unfunded lines and letters of credit. Other smaller decreases also contributed to the overall decrease in other noninterest expenses.

Other noninterest expense increased \$233,000 in 2016 and consisted primarily of an increase of \$191,000 in recruiting expense.

Income Taxes

Income tax expense decreased \$6.5 million in 2017 and \$726,000 in 2016. The decrease in 2017 was due to the income tax benefit of \$2.6 million for the year ended December 31, 2017, compared with the income tax expense of \$3.9 million for the same period in 2016. During the fourth quarter of 2017, we increased our income tax provision by \$3.6 million to revalue our net deferred tax assets as a result of the federal corporate tax rate change. Our effective tax rate approximated 18%, 29%, and 29% in 2017, 2016 and 2015, respectively. The effective tax rate for 2017 was impacted by the adjustment of our net deferred tax assets related to the reduction in the federal corporate tax rate under the Tax Cuts and Jobs Act. The impact of nontaxable municipal interest income and other tax considerations also contributed to lower effective tax rates for each of the three years presented in the Consolidated Statement of Earnings included in Item 8 of this filing. The notes to the consolidated financial statements provide additional information regarding income tax considerations.

Balance Sheet Analysis

Investment Securities

Total investment securities decreased \$49.8 million in 2017, from \$440.1 million in 2016 to \$390.2 million at December 31, 2017. The decrease resulted primarily from \$71.9 million in maturities and calls of securities and \$20.2

million in sales of securities, which were offset by \$45.9 million in purchases. Average duration of the portfolio was approximately 3.2 years as of December 31, 2017 and the average taxable-equivalent yield was 2.67%. For the year ended December 31, 2016, average duration of the portfolio was 3.2 years and the average taxable-equivalent yield was 2.55%. Unrealized net losses before tax effect in the securities available-for-sale portfolio were \$3.5 million at December 31, 2017, compared to \$2.5 million at December 31, 2016. These amounts resulted from interest rate fluctuations.

At December 31, 2017, approximately \$259.5 million, or 83.9%, of the securities available-for-sale portfolio represented mortgage-backed securities and CMOs. All of the mortgage-backed securities and CMOs are government agency sponsored with the exception of one privately issued CMO with a current market value of \$7,000. Risk due to changes in interest rates on mortgage-backed pools is monitored by monthly reviews of prepayment speeds, duration, and purchase yields as compared to current market yields on each security. CMOs totaled \$200.4 million and represented pools that each had a book value of less

than 10% of stockholders' equity at December 31, 2017. The mutual fund in the securities available-for-sale portfolio is a CRA Qualified Investment Fund. The CRA Fund is a market-rate bond fund that invests in high credit quality fixed income securities whose proceeds are designed to positively impact communities throughout the United States. The fair value of the security at December 31, 2017 totaled \$2.1 million. The fair value of our corporate debt securities at December 31, 2017 totaled \$24.8 million. Of this total, \$10.8 million represented senior debt instruments and \$14.0 represented subordinated debt instruments. An additional 7.4% of the available-for-sale portfolio consisted of municipal securities. At December 31, 2017, approximately \$45.1 million, or 55.7%, of the held-to-maturity portfolio represented mortgage-backed securities and CMOs. The remainder of the held-to-maturity portfolio, approximately \$35.9 million, consisted of municipal securities.

Additional information on our investment securities portfolio is provided in Note 2 of the notes to consolidated financial statements.

Table 6
Carrying Value of Investment Securities
December 31,
(in thousands)

	2017	2016	2015	2014	2013
Available-for-sale securities					
U. S. Government sponsored enterprises	\$—	\$—	\$—	\$10,227	\$11,265
Obligations of state and political subdivisions	22,809	29,141	31,493	44,605	59,978
GSE mortgage-backed securities	59,124	73,578	87,038	109,103	145,965
Collateralized mortgage obligations: residential	198,155	220,202	192,088	60,839	70,887
Collateralized mortgage obligations: commercial	2,240	3,082	5,448	24,545	27,346
Other asset-backed securities	—	—	—	24,343	25,489
Collateralized debt obligation	—	—	—	1,218	735
Mutual funds	2,061	2,059	2,092	2,104	—
Corporate debt securities	24,802	13,811	—	—	—
Total available-for-sale securities	\$309,191	\$341,873	\$318,159	\$276,984	\$341,665
Held-to-maturity securities					
Obligations of state and political subdivisions	\$35,908	\$40,515	\$43,737	\$45,914	\$47,377
GSE mortgage-backed securities	35,751	44,375	55,696	67,268	78,272
Collateralized mortgage obligations: residential	7,450	8,969	10,803	12,709	14,189
Collateralized mortgage obligations: commercial	1,943	4,352	6,556	15,310	15,685
Total held-to-maturity securities	\$81,052	\$98,211	\$116,792	\$141,201	\$155,523
Total investment securities	\$390,243	\$440,084	\$434,951	\$418,185	\$497,188

Table 7

Investment Securities Portfolio

Debt Security Maturities and Average Taxable-Equivalent Yields

At December 31, 2017

(dollars in thousands)

	Within 1 Year		After 1 but Within 5 Years		After 5 but Within 10 Years		After 10 Years		Total
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	
Securities available-for-sale:									
Obligations of state and political subdivisions ¹	\$1,136	6.02%	\$1,931	6.43%	\$1,763	3.42%	\$17,979	4.43%	\$22,809
GSE mortgage-backs and CMOs: residential	—	— %	—	— %	23,399	2.96%	233,880	2.65%	257,279
CMOs: commercial	—	—	—	— %	—	—	2,240	2.01%	2,240
Corporate debt securities	—	— %	6,665	5.89%	18,137	5.96%	—	— %	24,802
Total fair value	\$1,136		\$8,596		\$43,299		\$254,099		\$307,130
	Within 1 Year		After 1 but Within 5 Years		After 5 but Within 10 Years		After 10 Years		Total
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	
Held-to-Maturity:									
Obligations of state and political subdivisions ¹	\$1,201	2.59%	\$5,395	2.73%	\$11,124	3.31%	\$18,188	3.35%	\$35,908
GSE mortgage-backs and CMOs: residential	—	— %	—	— %	30,661	2.64%	12,540	1.80%	43,201
CMOs: commercial	—	— %	—	— %	—	— %	1,943	2.22%	1,943
Total cost	\$1,201		\$5,395		\$41,785		\$32,671		\$81,052

¹ Tax exempt yields are expressed on a fully taxable equivalent basis.

Loan Portfolio

The loan portfolio decreased \$100.7 million, or 7.8%, during 2017 primarily as a result of our focused efforts to decrease nonperforming loans, which also resulted in net charge-offs during 2017 of \$27.7 million. Decreases of \$32.7 million, \$26.3 million and \$24.4 million were in the commercial real estate, consumer, and commercial portfolios, respectively. There were also decreases of \$11.1 million and \$10.7 million in residential real estate and construction loan portfolios, respectively.

Our loan portfolio is diversified throughout our Louisiana and Texas markets, with a focus on C&I and CRE loans. Our C&I and CRE loans are primarily underwritten on cash flow analyses versus collateral valuations. The C&I portfolio consists primarily of term loans or revolving lines of credit which are generally structured with annual maturity. The term loans are generally structured with fixed rates and three to five year maturities. The CRE portfolio consists primarily of credits that have fifteen to twenty year amortization terms with rates fixed primarily for three years, but up to five years. We believe the shorter term structure of our C&I and CRE credits allows greater flexibility in controlling interest rate risk.

The loan portfolio at December 31, 2017 consisted of approximately 32.7% in fixed rate loans, with the majority maturing within five years. Approximately 67.3% of the portfolio earns a variable rate of interest, the greater majority of which adjusts simultaneous with changes in the Prime rate and a smaller portion that adjusts on a scheduled repricing date. The mix of variable and fixed rate loans provides some protection from changes in market rates of

interest. Additionally, we have established rate floors, primarily for our commercial loans, that provided some protection to our net interest margin during the current sustained low interest rate environment.

- 40 -

Table 8
Composition of Loans
December 31,
(in thousands)

	2017	2016	2015	2014	2013
Commercial, financial, and agricultural	\$435,207	\$459,574	\$454,028	\$467,147	\$403,976
Real estate – construction	90,287	100,959	74,952	68,577	82,691
Real estate – commercial	448,406	481,155	471,141	467,172	397,135
Real estate – residential	146,751	157,872	149,064	154,602	146,841
Installment loans to individuals	56,398	82,660	111,009	119,328	97,459
Lease financing receivable	732	1,095	1,968	4,857	5,542
Other	5,645	767	1,483	2,748	3,910
Total loans	\$1,183,426	\$1,284,082	\$1,263,645	\$1,284,431	\$1,137,554

Table 9
Loan Maturities and Sensitivity to Interest Rates
For the Year Ended December 31, 2017
(in thousands)

	Fixed and Variable Rate Loans at Stated Maturities				Amounts Over One Year With		
	1 Year or Less	1 Year – 5 Years	Over 5 years	Total	Predetermined Rates	Floating Rates	Total
Commercial, financial, and agricultural	\$35,680	\$321,201	\$78,326	\$435,207	\$150,383	\$249,144	\$399,527
Real estate – construction	1,440	62,889	25,958	90,287	37,462	51,385	88,847
Real estate – commercial	4,149	80,294	363,963	448,406	84,930	359,327	444,257
Real estate – residential	1,838	28,863	116,050	146,751	52,974	91,939	144,913
Installment loans to individuals	6,255	39,743	10,400	56,398	41,410	8,733	50,143
Lease financing receivable	—	124	608	732	732	—	732
Other	291	407	4,947	5,645	493	4,861	5,354
Total	\$49,653	\$533,521	\$600,252	\$1,183,426	\$368,384	\$765,389	\$1,133,773

Asset Quality

Credit Risk Management

We manage credit risk by observing written, board approved policies that govern all underwriting activities. Our Chief Credit Officer (“CCO”) is responsible for credit underwriting as well as management of classified and criticized assets for the Bank. The role of CCO includes on-going review and development of lending policies, commercial credit analysis, centralized consumer underwriting, loan operations documentation and funding, and overall credit risk management procedures. The current risk management process requires that each individual loan officer review his or her portfolio on a quarterly basis and assign recommended credit ratings on each loan. These efforts are supplemented by reviews performed by an independent loan reviewer and other validations performed by the internal audit department. Completed loan applications, credit bureau reports, financial statements, and a committee approval process remain a part of credit decisions. Documentation of the loan decision process is required on each credit application, whether approved or denied, to ensure thorough and consistent procedures.

Our loan review process also includes monitoring and reporting of loan concentrations whereby individual customer and aggregate industry leverage, profitability, risk rating distributions, and liquidity are evaluated for each major standard industry classification segment. At December 31, 2017, one industry segment concentration, the oil and gas industry, aggregated more than 10% of our loan portfolio. We define an energy loan as any loan where the borrower's

ability to repay is disproportionately impacted by a prolonged downturn in energy prices. Under this definition, the Bank includes direct C&I loans to energy borrowers, as well as CRE loans, Residential Real Estate loans and loans to energy-related borrowers where the loan's primary collateral is cash and marketable securities. Although this definition has resulted in a lack of comparability with some other energy-related

- 41 -

banks, management believes it to be the prudent approach to monitoring and managing the Bank's energy exposure. Our exposure in the oil and gas industry, as defined above, totaled approximately \$179.7 million, or 15.2% of total loans. The average loan size is approximately \$419,000, and the average loan size per relationship is roughly \$563,000. Of the \$179.7 million to borrowers in the oil and gas industry, \$35.8 million or 19.9% were on nonaccrual status at December 31, 2017. We are closely monitoring the effects of the sustained decline in oil prices on our energy related loan portfolio. We continue to communicate with our customers who provide valuable insight on the present energy cycle. The energy reserve as a percentage of total energy loans was 6.6% at December 31, 2017. Energy-related charge-offs during 2017 totaled \$12.7 million.

The federal banking agencies, including the OCC, 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 construction, land development and other land represent 100% or more of total capital or (2) total reported loans secured by multifamily and non-farm residential properties and loans for construction, land development and other land represent 300% or more of total capital. Owner occupied loans are excluded from this second category. We monitor our exposure to each of these segments to ensure the concentration is consistent with our risk tolerance. At December 31, 2017, loans for construction, land development and other land totaled approximately \$90.3 million, or 45% of our bank's risk-based capital. Loans secured by multifamily and non-farm residential properties and loans for construction, land development and other land totaled approximately \$260.9 million at December 31, 2017, or 129% of our bank's risk-based capital.

Nonperforming Assets

Table 10 contains information about nonperforming assets, including loans past due 90 days or greater ("90 days or >") and still accruing.

Table 10
Asset Quality Information
December 31,
(dollars in thousands)

	2017	2016	2015	2014	2013	
Loans on nonaccrual	\$49,278	\$62,580	\$50,051	\$10,701	\$5,099	
Loans past due 90 days or > and still accruing	728	268	147	187	178	
Total nonperforming loans	50,006	62,848	50,198	10,888	5,277	
Nonperforming loans held for sale	5,067	—	—	—	—	
Other real estate owned	2,001	2,175	4,187	4,234	6,687	
Other assets repossessed	192	16	38	—	20	
Total nonperforming assets	\$57,266	\$65,039	\$54,423	\$15,122	\$11,984	
Troubled debt restructurings, accruing ⁽¹⁾	\$1,360	\$152	\$164	\$176	\$179	
Nonperforming loans to total loans + ORE + other foreclosed assets	4.83	% 5.06	% 4.29	% 1.17	% 1.05	%
Nonperforming assets to total assets	3.04	% 3.35	% 2.82	% 0.78	% 0.65	%
ALLL to nonperforming loans	53.77	% 38.78	% 37.87	% 103.10	% 166.36	%
ALLL to total loans	2.27	% 1.90	% 1.50	% 0.87	% 0.77	%

⁽¹⁾Does not include \$8.6 million, \$25.1 million, \$20.9 million, \$234,000 and \$233,000 of TDRs reported in nonaccrual loans at December 31, 2017, 2016, 2015, 2014 and 2013, respectively.

Nonperforming assets totaled \$57.3 million at December 31, 2017, a decrease of \$7.7 million over the \$65.0 million reported for year-end 2016. The decrease resulted primarily from a \$13.3 million decrease in nonaccrual loans, which was partially offset by a \$5.1 million increase in nonperforming loans held for sale at December 31, 2017. The allowance coverage for nonperforming loans increased during 2017, from 38.78% at December 31, 2016 to 53.77% at

December 31, 2017. Classified assets, including ORE, decreased \$16.0 million or 11.9%, from \$134.2 million at December 31, 2016 to \$118.2 million at December 31, 2017. The decrease in classified assets was primarily due to the payoffs as well as charge-offs of loans in addition to the write down of some classified loans to fair value when they were transferred to held for sale. Year-to-date net charge-offs were 2.26% of average total loans as of December 31, 2017 compared to 0.41% as of December 31, 2016. The ALL/total loans ratio improved by 37 basis points to 2.27% at December 31, 2017 compared to 1.90% at December 31, 2016 as a result of a \$30.2 million provision for loan losses recorded during the year ended December 31, 2017.

Loans classified as TDRs totaled \$9.9 million at December 31, 2017 compared to \$25.3 million at December 31, 2016. These totals included \$8.6 million and \$25.1 million, respectively, of loans reported in nonaccrual loans. The decrease in loans from December 31, 2016 was primarily the result of \$6.7 million in charge-offs of TDRs during 2017 as well as the payoff of \$10.6 of TDRs during the year. These decreases were partially offset by \$2.0 million of loans identified as TDRs during the year. Additional information regarding impaired loans and TDRs is included in the notes to the consolidated financial statements.

Consumer and commercial loans are placed on nonaccrual status when principal or interest is 90 days past due, or sooner if the full collectibility of principal or interest is doubtful, except if the underlying collateral fully supports both the principal and accrued interest and the loan is in the process of collection. Our policy provides that unsecured retail (consumer) loans that become 90 days delinquent be routinely charged off. Loans classified for regulatory purposes but not included in Table 10 do not represent material amounts that we have serious doubts as to the ability of the borrower to comply with loan repayment terms. Further information regarding loan policy is provided in the notes to the consolidated financial statements.

Allowance for Loan Losses

Provisions totaling \$30.2 million, \$10.6 million, and \$13.9 million, for the years 2017, 2016, and 2015, respectively, were considered necessary to bring the allowance for loan losses to a level we believe sufficient to cover probable losses in the loan portfolio. Table 11 analyzes activity in the allowance for 2017, 2016, 2015, 2014, and 2013.

Table 11

Summary of Loan Loss Experience

For the Year Ended December 31,

(dollars in thousands)

	2017	2016	2015	2014	2013	
Balance at beginning of year	\$24,372	\$19,011	\$11,226	\$8,779	\$7,370	
Charge-offs:						
Commercial, financial, and agricultural	20,451	4,366	4,936	2,843	935	
Real estate – construction	70	—	105	1	—	
Real estate – commercial	6,648	218	183	93	18	
Real estate – residential	543	24	87	273	129	
Installment loans to individuals	1,165	1,407	1,263	706	824	
Total charge-offs	28,877	6,015	6,574	3,916	1,906	
Recoveries:						
Commercial, financial, and agricultural	652	459	235	164	80	
Real estate – construction	—	—	3	—	8	
Real estate – commercial	162	123	26	407	29	
Real estate – residential	105	5	12	47	39	
Installment loans to individuals	274	189	183	120	109	
Total recoveries	1,193	776	459	738	265	
Net charge-offs	27,684	5,239	6,115	3,178	1,641	
Additions to allowance charged to operating expenses	30,200	10,600	13,900	5,625	3,050	
Balance at end of year	\$26,888	\$24,372	\$19,011	\$11,226	\$8,779	
Net charge-offs to average loans	2.26	% 0.41	% 0.47	% 0.26	% 0.15	%
Year-end allowance to year-end loans	2.27	% 1.90	% 1.50	% 0.87	% 0.77	%

Table 12
Allocation of Loan Loss by Category
December 31,
(dollars in thousands)

	2017		2016		2015		2014		2013	
	Amount	% of loans to total loans	Amount	% of loans to total loans	Amount	% of loans to total loans	Amount	% of loans to total loans	Amount	% of loans to total loans
Commercial, financial, and agricultural	\$20,577	36.8	\$16,057	35.8	\$11,268	35.9	\$5,729	36.4	\$3,906	35.5
Real estate - construction	596	7.6	585	7.8	819	5.9	954	5.3	1,046	7.3
Real estate - commercial	3,893	37.9	5,384	37.5	4,614	37.3	2,402	36.4	1,389	34.9
Real estate - residential	837	12.4	940	12.3	816	11.8	810	12.0	1,141	12.9
Installment loans to individuals	957	4.8	1,395	6.4	1,468	8.8	1,311	9.3	1,273	8.6
Lease financing receivable	3	0.1	5	0.1	14	0.2	16	0.4	21	0.5
Other	25	0.4	6	0.1	12	0.1	4	0.2	3	0.3
	\$26,888	100.0	\$24,372	100.0	\$19,011	100.0	\$11,226	100.0	\$8,779	100.0

Net charge-offs during 2017 totaled \$27.7 million, compared to \$5.2 million during 2016 and \$6.1 million during 2015. The increase in net charge-offs during 2017 was primarily a result of energy related charge-offs totaling \$12.7 million during 2017 as well as charge-offs of two real estate loans unrelated to energy that totaled \$3.7 million.

Quarterly evaluations of the allowance for loan losses are performed in accordance with GAAP and regulatory guidelines. The allowance is comprised of specific reserves assigned to each impaired loan for which probable loss has been identified as well as general reserves to maintain the allowance at an acceptable level for other loans in the portfolio where historical loss experience is available that indicates certain probable losses may exist. Factors considered in determining provisions include estimated losses in significant credits; known deterioration in concentrations of credit; historical loss experience; trends in nonperforming assets; volume, maturity and composition of the loan portfolio; off-balance sheet credit risk; lending policies and control systems; national and local economic conditions; the experience, ability and depth of lending management; and the results of examinations of the loan portfolio by regulatory agencies and others. The processes by which we determine the appropriate level of the allowance, and the corresponding provision for probable credit losses, involves considerable judgment; therefore, no assurance can be given that future losses will not vary from current estimates. Additional information regarding the allowance for loan losses is included in the notes to the consolidated financial statements.

Funding Sources

Deposits

As of December 31, 2017, total deposits decreased \$99.7 million, or 6.3%, to \$1.5 billion following an increase of \$28.6 million in 2016. Noninterest-bearing deposits increased \$1.6 million in 2017 to \$416.5 million and represented 28.1% of total deposits at December 31, 2017, compared to 26.3% at December 31, 2016 and 24.1% at December 31, 2015. During 2017, interest-bearing deposits in money market and savings accounts decreased \$93.6 million and NOW account deposits decreased \$37.8 million. Time deposits, which are comprised mostly of certificates of deposits ("CDs"), increased \$30.1 million in 2017, which was primarily attributable to a \$45.8 million increase in brokered CDs. The increase in total deposits during 2016 resulted primarily from increases of \$40.7 million and \$8.4 million in noninterest-bearing deposits and money market and savings accounts, respectively. These decreases were partially offset by decreases of \$17.6 million and \$2.9 million in CDs and NOW accounts, respectively. Core deposits,

defined as all deposits other than time deposits, remained strong at 87.6% of total deposits at year-end 2017 compared to 90.4% of total deposits at year-end 2016. Core deposits totaled 89.1% of total deposits at year-end 2015. To manage the net interest margin and core deposit balances, we typically offer low- to mid-market rates on CDs. Additional information on deposits appears in the tables below and in the notes to the consolidated financial statements.

- 44 -

Table 13
Summary of Average Deposits
(in thousands)

	2017		2016		2015	
	Average Amount	Average Yield	Average Amount	Average Yield	Average Amount	Average Yield
Noninterest-bearing demand deposits	\$423,954	—	\$390,585	—	\$405,571	—
Interest-bearing deposits:						
Savings, NOW, and money market	952,238	0.32 %	1,014,772	0.29 %	943,615	0.23 %
Time deposits	168,766	0.65 %	161,926	0.46 %	226,188	0.61 %
Total	\$1,544,958	0.27 %	\$1,567,283	0.23 %	\$1,575,374	0.23 %

Table 14
Maturity Schedule Time Deposits of \$250,000 or More
December 31,
(in thousands)

	2017	2016	2015
3 months or less	\$8,346	\$9,785	\$10,765
Over 3 months through 6 months	4,934	7,730	8,689
Over 6 months through 12 months	6,095	9,052	10,932
Over 12 months	6,610	5,244	7,059
Total	\$25,985	\$31,811	\$37,445

Borrowed Funds

As of December 31, 2017, we had securities sold under repurchase agreements totaling \$67.1 million and no federal funds purchased. At December 31, 2016, we had \$94.5 million in securities sold under repurchase agreements and no federal funds purchased. Retail repurchase agreements, included in securities sold under agreements to repurchase, decreased \$14.9 million, from \$82.0 million at December 31, 2016 to \$67.1 million at December 31, 2017. Also included in securities sold under agreements to repurchase at December 31, 2016 was a \$12.5 million reverse repurchase agreement we entered into with Citigroup Markets, Inc. (“CGMI”) in July of 2007 to meet liquidity demands. Under the terms of the agreement, interest was payable at a fixed rate of 4.57% for the remainder of the term. The security was repurchased on August 9, 2017.

Long-term FHLB-Dallas advances totaled \$10.0 million at December 31, 2017, compared to \$25.4 million at December 31, 2016. Long-term FHLB advances at December 31, 2017 consisted of one advance that matures in January 2019 and bears a fixed interest rate of 1.985%. Short-term FHLB-Dallas advances totaled \$40.0 million at December 31, 2017. There were no short-term FHLB-Dallas advances outstanding at December 31, 2016. Short-term FHLB advances at December 31, 2017 consisted of two FHLB advances with a maturity of 1 month at a fixed interest rate of 1.59%. The FHLB advances are collateralized by a blanket lien on first mortgages and other qualifying loans.

A description of the junior subordinated debentures outstanding as of December 31, 2017 is as follows:

Table 15
Junior Subordinated Debentures
(dollars in thousands)

Date Issued	Maturity Date	Interest Rate	Callable After	Amount
July 31, 2001	July 9, 2031	3 month LIBOR plus 3.30%	July 31, 2006	\$5,671
September 20, 2004	September 20, 2034	3 month LIBOR plus 2.50%	September 20, 2009	8,248
October 12, 2006	October 12, 2036	3 month LIBOR plus 1.85%	June 26, 2011	5,155
June 21, 2007	June 21, 2037	3 month LIBOR plus 1.70%	June 15, 2012	3,093

\$22,167

- 45 -

Our outstanding debentures currently qualify as Tier 1 capital and are presented in the Consolidated Balance Sheets as junior subordinated debentures. Additional information regarding long-term debt is provided in the notes to the consolidated financial statements.

Regulations adopted as a result of the Dodd-Frank Act have resulted in changes to the regulatory capital treatment of securities similar to our debentures. However, because of the issue date of our debentures and our asset size, we are allowed to continue to include the debentures in our Tier 1 capital.

In 2017, 2016, and 2015, we did not have an average balance in any category of short-term borrowings including retail repurchase agreements, reverse repurchase agreements, federal funds purchased, or FRB discount window that exceeded 30% of our stockholders' equity for such year.

Capital

As described under "Business - Supervision and Regulation," we are required to maintain certain minimum capital levels for the Company and the Bank. Risk-based capital requirements are intended to make regulatory capital more sensitive to the risk profile of an institution's assets. In July 2013, the Federal Reserve and the OCC issued final rules establishing a new comprehensive capital framework for U.S. banking organizations that implement the Basel III capital framework and certain provisions of the Dodd-Frank Act. The final rules seek to strengthen the components of regulatory capital, increase risk-based capital requirements, and make selected changes to the calculation of risk-weighted assets. Details regarding the final rule and changes to capital requirements and prompt corrective action thresholds are included under Part I, Item 1 – Business, Supervision and Regulation. The final rules became effective as of January 1, 2015, for most banking organizations including the Company and the Bank, subject to a transition period for several aspects of the final rules, including the new minimum capital ratio requirements, the capital conservation buffer, and the regulatory capital adjustments and deductions. Requirements to maintain higher levels of capital could adversely impact our return on equity. We believe we will continue to exceed all estimated well-capitalized regulatory requirements under these new rules on a fully phased-in basis.

On June 13, 2017, the Company completed the sale of 4,583,334 shares of its common stock pursuant to an underwritten public offering, and on July 11, 2017, the Company completed the sale of an additional 516,700 shares of common stock, pursuant to the partial exercise of the option to purchase additional shares granted to the underwriter. After deducting the underwriting discount and costs associated with the capital raise, the offering resulted in net proceeds of \$57.2 million.

At December 31, 2017, the Company and the Bank were in compliance with statutory minimum capital requirements. Minimum capital requirements include a total risk-based capital ratio of 8.0%, with Tier 1 capital not less than 6.0%, common equity Tier 1 capital not less than 4.5% and a leverage ratio (Tier 1 capital to total average adjusted assets) of 4.0% based upon the regulators latest composite rating of the institution. In addition, the OCC has established higher individual minimum capital ratios for the Bank. Specifically, the Bank must maintain a Tier 1 leverage ratio of at least 8%, and a total risk-based capital ratio of at least 12%. As of December 31, 2017, the Company's leverage ratio was 12.53% compared to 10.11% at December 31, 2016. Tier 1 capital to risk weighted assets was 16.51% and 13.02% for 2017 and 2016, respectively. Total capital to risk weighted assets was 17.77% and 14.28%, respectively, for the same periods. Common equity Tier 1 capital to risk weighted assets was 12.10% and 8.81%, respectively, for the same periods. For regulatory purposes, Tier 1 Capital includes \$21.5 million of the junior subordinated debentures issued by the Company. For financial reporting purposes, these funds are included as a liability under GAAP. The Bank's leverage ratio was 9.86% and 9.32% at December 31, 2017 and 2016, respectively.

The FDIC Improvement Act of 1991 established a capital-based supervisory system for all insured depository institutions that imposes increasing restrictions on the institution as its capital deteriorates. The Bank was classified as "well capitalized" as of December 31, 2017.

As discussed under the heading Balance Sheet Analysis - Securities, \$3.4 million in unrealized losses on securities available-for-sale, less a deferred tax asset of \$713,000, was recorded as a reduction to stockholders' equity as of December 31, 2017. In addition, the effective portion of the gain or loss of our derivative instruments designated as cash flow hedges is recorded as a component of other comprehensive income. As of December 31, 2017, a \$1.1 million gain on our derivative instruments designated as cash flow hedges, less a deferred tax liability of \$227,000, was recorded as an addition to stockholders' equity. As of December 31, 2016, \$2.5 million in unrealized losses on securities available-for-sale, less a deferred tax asset of \$890,000, was recorded as an addition to stockholders' equity. As of December 31, 2016, a \$989,000 gain on our derivative instruments designated as cash flow hedges, less a deferred tax liability of \$346,000, was recorded as an addition to stockholders' equity. While the net unrealized gain or loss on securities available-for-sale and the fair value of derivative instruments designated as cash flow hedges are required to be reported as a separate component of stockholders' equity, they do not affect operating results

- 46 -

or regulatory capital ratios. The net unrealized gains and losses reported for December 31, 2017 and 2016, however, did affect the equity-to-assets ratio for financial reporting purposes. The ratio of equity-to-assets was 13.50% at December 31, 2017 and 11.03% at December 31, 2016.

Asset/Liability Management and Interest Rate Sensitivity

Interest rate sensitivity is the sensitivity of net interest income and economic value of equity to changes in market rates of interest. The primary objective of our asset and liability management process is to evaluate interest rate sensitivity inherent in our balance sheet components and establish guidelines to manage that risk within acceptable performance levels. Management and our Board of Directors are responsible for determining the appropriate level of acceptable risk based on our strategic focus, regulatory requirements for capital and liquidity, and the market environment. Our Board of Directors established an Asset/Liability management committee (“ALCO”), comprised of certain executive and senior officers of the Bank, to measure and monitor interest rate risk within defined parameters. We utilize an external model for asset and liability management from our core processor. The model captures data directly from our operating system along with additional information regarding rates and prepayment characteristics to construct an analysis that presents differences in repricing, cash flows and the maturity characteristics of earning assets and interest-bearing liabilities for selected time periods.

This data, combined with additional assumptions including repricing rates and payment characteristics, were used to perform instantaneous parallel rate shift, gradual parallel rate shift, and alternate rate shift simulations. Instantaneous parallel rate shifts are known as “rate shocks” because all rates are modeled to change instantaneously by the indicated shock amount. Gradual parallel rate shifts are called "Ramps" and reflect incremental rate increases over a 12 month period. Alternate rate shifts include floor rates that generally provide more realistic projections of changes in net interest income and market risk, although given the current low rate environment deposits costs are overstated in a down 100 basis point scenario as the model does not currently allow for negative interest rates. Results of the simulations were compared to a base case scenario that provided projected net interest income over the next 12 months with no change in the balance sheet. The estimated percentage changes in projected net interest income due to changes in interest rates of alternate down 100 basis points, ramp up 100, parallel up 200, and up 300 basis points as determined through the simulations are detailed below. At December 31, 2017, the interest rate risk model results were within policy guidelines and indicated that our balance sheet is slightly liability sensitive over a one year period. The results of the interest rate risk modeling are reviewed by ALCO and discussed quarterly at Funds Management committee meetings of our Board of Directors. The model captures data directly from our operating system along with additional information regarding rates and prepayment characteristics to construct an analysis that presents differences in repricing, cash flows and the maturity characteristics of earning assets and interest-bearing liabilities for selected time periods. As a result of an independent non-maturity deposit study commissioned in 2016, we updated our deposit beta assumptions, which are correlation assumptions between deposit rates and market rates, in rising rate scenarios on a consolidated basis from 40% to 60%. The actual deposit betas experienced in a rising rate scenario could be materially different from those assumed in the model, and therefore actual net income could be materially different from estimated net interest income indicated in the table below.

Net Interest Income at Risk in Year 1

Changes in Interest Rates	Estimated Increase / Decrease in NII at December 31, 2017
Shock Up 300 basis points	(1.38)%
Shock Up 200 basis points	(1.49)%
Ramp Up 100 basis points	(0.60)%
Alternate Down 100 basis points	(2.95)%

Liquidity

Bank Liquidity

Liquidity is the availability of funds to meet maturing contractual obligations and to fund operations. The Bank's primary liquidity needs involve its ability to accommodate customers' demands for deposit withdrawals as well as customers' requests for credit. Liquidity is deemed adequate when sufficient cash to meet these needs can be promptly raised at a reasonable cost to the Bank.

Liquidity is provided primarily by three sources: a stable base of funding sources, an adequate level of assets that can be readily converted into cash, and borrowing lines with correspondent banks. Our core deposits are our most stable and important source of funding. Cash deposits at other banks, federal funds sold, and principal payments received on loans and mortgage-backed

- 47 -

securities provide additional primary sources of liquidity. Approximately \$66.2 million in projected cash flows from securities repayments during 2018 provides an additional source of liquidity.

The Bank also has significant borrowing capacity with the FRB-Atlanta and with the FHLB-Dallas. As of December 31, 2017, we had no borrowings with the FRB-Atlanta. Long-term FHLB-Dallas advances totaled \$10.0 million at December 31, 2017 and consisted of a fixed rate advance that matures in January 2019 and bears a fixed interest rate of 1.985%. Short-term FHLB advances at December 31, 2017 totaled \$40.0 million and consisted of two FHLB advances with a maturity of 1 month at a fixed interest rate of 1.59%. The Bank has the ability to post additional collateral of approximately \$210.6 million if necessary to meet liquidity needs. Additionally, \$171.1 million in loan collateral is pledged under a Borrower-in-Custody line with the FRB-Atlanta. Under existing agreements with the FHLB-Dallas, our borrowing capacity totaled \$237.8 million at December 31, 2017. Additional unsecured borrowing lines totaling \$33.5 million are available through correspondent banks. We utilize these contingency funding alternatives to meet deposit volatility, which is more likely in the current environment, given unusual competitive offerings within our markets.

Company Liquidity

In connection with the SBLF transaction, the Company issued \$32.0 million in Series B Preferred Stock to the Treasury. The dividend rate was set at 1.00% for the fourth quarter of 2013 due to attaining the target 10% growth rate in qualified small business loans during the second quarter of 2013. As a result of qualified small business loan growth as of September 30, 2013, the dividend rate was set at 1.00% for the period from January 1, 2014 through February 25, 2016. On February 25, 2016, the dividend rate increased to 9% per annum.

On June 13, 2017, the Company completed the sale of 4,583,334 shares of its common stock pursuant to an underwritten public offering, and on July 11, 2017, the Company completed the sale of an additional 516,700 shares of common stock, pursuant to the partial exercise of the option to purchase additional shares granted to the underwriter. After deducting the underwriting discount and costs associated with the capital raise, the offering resulted in net proceeds of \$57.2 million. The Company, subject to regulatory approval, intends to use \$32.0 million of the net proceeds to redeem all of the outstanding Series B Preferred Stock issued to the U.S. Treasury as a result of its participation in the SBLF. The Company intends to use the remaining portion of the net proceeds to enhance its capital structure, to fund future organic growth, for working capital, and other general corporate purposes.

At the Company level, cash is needed primarily to meet interest payments on the junior subordinated debentures, dividend payments on the Series B and Series C Preferred Stock and dividends on the common stock. We issued \$8,248,000 in unsecured junior subordinated debentures in September 2004 and \$7,217,000 in February 2001. In August 2014, we paid off the \$7.2 million junior subordinated debenture. In December 2012, we acquired \$13.9 million in unsecured junior subordinated debentures from PSB Financial Corporation. The terms of the junior subordinated debentures are described in the notes to the consolidated financial statements. Dividends from the Bank totaling \$4,000,000 provided additional liquidity prior to the capital raise for the Company to meet interest and dividend payments. Dividends totaling \$9,000,000 were paid by the Bank to the Company in 2016. Due to the loss reported for the year ended December 31, 2017, we currently do not have the ability to approve dividends from the Bank to the Company without prior approval from the OCC. At December 31, 2017, the parent company had approximately \$50.2 million cash available for general corporate purposes, including injecting capital into the Bank. As a publicly traded company, the Company also has the ability, subject to market conditions, to issue additional shares of common stock, preferred stock and other securities to provide funds as needed for operations and future growth of the Company and the Bank.

Dividends

The primary source of cash dividends on the Company's common stock is dividends from the Bank. Due to the loss reported for the year ended December 31, 2017, we currently do not have the ability to pay dividends from the Bank

to the Company without prior approval from the OCC. For additional information regarding restrictions on our ability to pay dividends see Part II, Item 5 under the heading “Market for Registrant's Common Equity, Related Shareholder Matters, and Issuer Purchases of Equity Securities.”

Cash dividends totaling \$3.7 million and \$4.1 million were declared to common stockholders during 2017 and 2016, respectively. Dividends declared on our Series B preferred stock totaled \$2.8 million and \$2.5 million during 2017 and 2016, respectively. Dividends declared on our Series C preferred stock totaled \$362,000 and \$365,000 during 2017 and 2016, respectively.

Off Balance Sheet Arrangements and Other Contractual Obligations

- 48 -

In the normal course of business we use various financial instruments with off-balance sheet risk to meet the financing needs of customers and to reduce exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the financial statements. We did not have an average balance in any category of short-term borrowings detailed below in 2017, 2016, or 2015 that exceeded 30% of our stockholders' equity for such year. Additional information regarding contractual obligations appears in the notes to the consolidated financial statements. The following table presents significant contractual obligations as of December 31, 2017.

Table 16
Contractual Obligations
December 31, 2017
(in thousands)

	Payment due by period				
	Total	1 year or less	> 1-3 years	> 3-5 years	More than 5 years
Time deposits	\$182,281	\$97,604	\$72,983	\$11,692	\$2
Short-term FHLB advances	40,000	40,000	—	—	—
Long-term debt obligations	32,188	—	10,021	—	22,167
Retail repurchase agreements	67,133	67,133	—	—	—
Operating lease obligations	12,815	1,814	3,636	1,908	5,457
Total	\$334,417	\$206,551	\$86,640	\$13,600	\$27,626

Impact of Inflation and Changing Prices

The consolidated financial statements and notes thereto, presented herein, have been prepared in accordance with GAAP, which generally require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time and due to inflation. The impact of inflation is reflected in the increased cost of operations. Unlike most industrial companies, nearly all of our assets and liabilities are financial in nature. As a result, interest rates generally have a greater impact on our performance than do the effects of general levels of inflation. For additional information, see "Funding Sources – Asset Liability Management and Interest Rate Sensitivity."

Non-GAAP Financial Measures

Certain financial information included in the Management's Discussion and Analysis of Financial Condition and Results of Operations is determined by methods other than in accordance with GAAP. Table 17 below presents a reconciliation of these non-GAAP financial measures to the most comparable GAAP financial measures. These non-GAAP financial measures include "core net interest income", "core net interest margin", "diluted earnings per share, operating" and "operating earnings available to common shareholders". "Core net interest income" is defined as net interest income excluding net purchase accounting adjustments. "Core net interest margin" is defined as core net interest income expressed as a percentage of average earnings assets. "Diluted earnings per share, operating" is defined as net earnings available to common shareholders adjusted for specified one-time items divided by diluted weighted-average shares. "Operating earnings available to common shareholders" is defined as net income available to common shareholders less tax-effected nonoperating income and expense items, including securities gains/losses.

We use non-GAAP measures because we believe they are useful for evaluating our financial condition and performance over periods of time, as well as in managing and evaluating our business and in discussions about our performance. We also believe these non-GAAP financial measures provide users of our financial information with a meaningful measure for assessing our financial condition as well as comparison to financial results for prior periods.

These results should not be viewed as a substitute for results determined in accordance with GAAP, and are not necessarily comparable to non-GAAP performance measures that other companies may use.

- 49 -

Table 17
Reconciliation of Non-GAAP Financial Measures
(in thousands except per share data)

	Year Ended December 31,			
	2017	2016	2015	
Core Net Interest Margin				
Net interest income (FTE)	\$75,382	\$73,264	\$76,311	
Less purchase accounting adjustments	(1,393)	(1,857)	(2,342)	
Core net interest income, net of purchase accounting adjustments	A \$73,989	\$71,407	\$73,969	
Total average earning assets	\$1,772,103	\$1,770,796	\$1,783,824	
Add average balance of loan valuation discount	1,605	2,799	4,507	
Average earnings assets, excluding loan valuation discount	B \$1,773,708	\$1,773,595	\$1,788,331	
Core net interest margin	A/B 4.17	% 4.03	% 4.14	%
Diluted (Loss) Earnings Per Share, Operating				
Diluted (loss) earnings per share	\$(1.06)	\$0.58	\$0.90	
Effect of net gain on sales of securities	(0.01)	—	(0.07)	
Effect of income from death benefit on bank owned life insurance	—	—	(0.01)	
Effect of gain on sale of branches	(0.04)	—	—	
Effect of severance and retention accruals	0.07	—	—	
Effect of one-time charge related to discontinued branch projects	0.02	—	—	
Effect of one-time charge related to closure of branches	0.04	—	—	
Effect of write-down of assets held for sale	0.06	—	—	
Effect of loss on transfer of loans to held for sale	0.28	—	—	
Effect of regulatory remediation costs	0.12	—	—	
Effect of write-down of net deferred tax asset resulting from the Tax Cuts and Jobs Act	0.25	—	—	
Diluted (loss) earnings per share, operating	\$(0.27)	\$0.58	\$0.82	
Operating (Loss) Earnings Available to Common Shareholders				
Net (loss) earnings available to common shareholders	\$(15,003)	\$6,578	\$10,330	
Effect of net gain on sales of securities, after-tax	(226)	(13)	(808)	
Effect of income from death benefit on bank owned life insurance	—	—	(160)	
Effect of gain on sale of branches, after-tax	(484)	—	—	
Effect of severance and retention accruals, after-tax	983	—	—	
Effect of one-time charge related to discontinued branch projects, after-tax	302	—	—	
Effect of one-time charge related to closure of branches, after-tax	587	—	—	
Effect of write-down of assets held for sale, after-tax	883	—	—	
Effect of loss on transfer of loans to held for sale, after-tax	3,920	—	—	
Effect of regulatory remediation costs, after-tax	1,708	—	—	
Effect of write-down of net deferred tax asset resulting from the Tax Cuts and Jobs Act	3,595	—	—	
Operating (loss) earnings available to common shareholders	\$(3,735)	\$6,565	\$9,362	

	Year Ended	
	December 31,	
	2017	2016 2015
Operating Return on Average Assets		
Return on average assets	0% 78%	34 0%53
Effect of non-operating revenues and expenses	0%59—%	0%05
Operating return on average assets	0% 19%	34 0%48
Operating Return on Average Equity		