Allegiance Bancshares, Inc.
Form 10-Q
May 08, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2018
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO
COMMISSION FILE NUMBER: 001-37585

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

Texas	26-3564100
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

8847 West Sam Houston Parkway, N., Suite 200
Houston, Texas 77040
(Address of principal executive offices, including zip code)
(281) 894-3200
(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company or an emerging growth company. See definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting,” and “emerging growth company” in Rule 12b-2 of the Exchange Act:

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of May 4, 2018, there were 13,325,736 outstanding shares of the registrant's Common Stock, par value $1.00 per share.

ALLEGIANCE BANCSHARES, INC.
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PART I—FINANCIAL INFORMATION
ITEM 1. INTERIM CONSOLIDATED FINANCIAL STATEMENTS
ALLEGIANCE BANCSHARES, INC.
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 31, 2018	December 31, 2017
	(Dollars in thousands, except share data)	
ASSETS		
Cash and due from banks	$143,176	$133,124
Interest-bearing deposits at other financial institutions	46,912	48,979
Total cash and cash equivalents	190,088	182,103
Available for sale securities, at fair value	307,411	309,615
Loans held for investment	2,290,494	2,270,876
Less: allowance for loan losses	(24,628)	(23,649)
Loans, net	2,265,866	2,247,227
Accrued interest receivable	10,521	12,194
Premises and equipment, net	18,605	18,477
Other real estate owned	365	365
Federal Home Loan Bank stock	14,128	12,862
Bank owned life insurance	22,563	22,422
Goodwill	39,389	39,389
Core deposit intangibles, net	3,079	3,274
Other assets	14,469	12,303
TOTAL ASSETS	$2,886,484	$2,860,231
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	$694,880	$683,110
Interest-bearing		
Demand	143,178	215,499
Money market and savings	583,967	554,051
Certificates and other time	862,777	761,314
Total interest-bearing deposits	1,589,922	1,530,864
Total deposits	2,284,802	2,213,974
Accrued interest payable	1,212	610
Borrowed funds	232,569	282,569
Subordinated debt	48,719	48,659
Other liabilities	7,194	7,554
Total liabilities	2,574,496	2,553,366
COMMITMENTS AND CONTINGENCIES (See Note 11)		
SHAREHOLDERS' EQUITY:		
Preferred stock, $1 par value; 1,000,000 shares authorized; no shares issued or outstanding	—	—

Common stock, $1 par value; 40,000,000 shares authorized; 13,302,462 shares issued and outstanding at March 31, 2018 and 13,226,826 shares issued and outstanding at December 31, 2017	13,302	13,227
Capital surplus	219,760	218,408
Retained earnings	82,533	74,894
Accumulated other comprehensive (loss) income	(3,607)	336
Total shareholders’ equity	311,988	306,865
TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY	$2,886,484	$2,860,231

See condensed notes to interim consolidated financial statements.

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

	Three Months Ended March 31,	
	2018	2017
	(Dollars in thousands, except per share data)	
INTEREST INCOME:		
Loans, including fees	$30,117	$25,260
Securities:		
Taxable	599	498
Tax-exempt	1,459	1,624
Deposits in other financial institutions	216	130
Total interest income	32,391	27,512
INTEREST EXPENSE:		
Demand, money market and savings deposits	976	654
Certificates and other time deposits	2,785	1,957
Borrowed funds	1,036	653
Subordinated debt	705	120
Total interest expense	5,502	3,384
NET INTEREST INCOME	26,889	24,128
Provision for loan losses	653	1,343
Net interest income after provision for loan losses	26,236	22,785
NONINTEREST INCOME:		
Nonsufficient funds fees	176	199
Service charges on deposit accounts	223	195
Bank owned life insurance income	141	148
Rebate from correspondent bank	444	233
Other	662	566
Total noninterest income	1,646	1,341
NONINTEREST EXPENSE:		
Salaries and employee benefits	12,794	10,562
Net occupancy and equipment	1,272	1,427
Depreciation	407	400
Data processing and software amortization	1,053	695
Professional fees	469	895
Regulatory assessments and FDIC insurance	534	589
Core deposit intangibles amortization	195	195
Communications	248	247
Advertising	330	263
Other	1,415	1,276
Total noninterest expense	18,717	16,549
INCOME BEFORE INCOME TAXES	9,165	7,577
Provision for income taxes	1,454	1,530
NET INCOME	$7,711	$6,047

EARNINGS PER SHARE:		
Basic	$0.58	$0.46
Diluted	$0.57	$0.45

See condensed notes to interim consolidated financial statements.

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

	Three Months Ended March 31,	
	2018	2017
	(Dollars in thousands)	
Net income	$7,711	$6,047
Other comprehensive (loss) income, before tax:		
Unrealized (loss) gain on securities:		
Change in unrealized holding (loss) gain on available for sale securities during the period	(5,082)	1,197
Total other comprehensive (loss) income	(5,082)	1,197
Deferred tax benefit (expense) related to other comprehensive (loss) income	1,139	(419)
Other comprehensive (loss) income, net of tax	(3,943)	778
Comprehensive income	$3,768	$6,825

See condensed notes to interim consolidated financial statements.

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ALLEGIANCE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Unaudited)

	Common Stock		Capital	Retained	Accumulated Other Comprehensive	Treasury	Total Shareholders'
	Shares	Amount	Surplus	Earnings	Income (Loss)	Stock	Equity
	(In thousands, except share data)						
BALANCE AT JANUARY 1, 2017	12,958,341	$12,958	$212,649	$57,262	$ (3,052)	$ —	$ 279,817
Net income				6,047			6,047
Other comprehensive income					778		778
Common stock issued in connection with the exercise of stock options and restricted stock awards	122,101	122	2,025				2,147
Repurchase of treasury stock						—	—
Stock based compensation expense			341				341
BALANCE AT MARCH 31, 2017	13,080,442	$13,080	$215,015	$63,309	$ (2,274)	$ —	$ 289,130
BALANCE AT JANUARY 1, 2018	13,226,826	$13,227	$218,408	$74,894	$ 336	$ —	$ 306,865
Net income				7,711			7,711
Other comprehensive loss					(3,943)		(3,943)
Reclassification of amounts within AOCI to retained earnings due to tax reform (See Notes 1)				(72)			(72)
Common stock issued in connection with the exercise of stock options and restricted stock awards	75,636	75	914				989
Stock based compensation expense			438				438
BALANCE AT MARCH 31, 2018	13,302,462	$13,302	$219,760	$82,533	$ (3,607)	$ —	$ 311,988

See condensed notes to interim consolidated financial statements.

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

	Three Months Ended March 31,	
	2018	2017
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$7,711	$6,047
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and core deposit intangibles amortization	602	595
Provision for loan losses	653	1,343
Excess tax benefit related to the exercise of stock options	(224)	(631)
Net amortization of premium on investments	832	826
Bank owned life insurance	(141)	(148)
Net accretion of discount on loans	(632)	(236)
Net amortization of discount on subordinated debentures	27	26
Net amortization of discount on certificates of deposit	(3)	(253)
Federal Home Loan Bank stock dividends	(67)	(46)
Stock based compensation expense	438	341
Decrease in accrued interest receivable and other assets	1,116	698
Increase in accrued interest payable and other liabilities	499	545
Net cash provided by operating activities	10,811	9,107
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities and principal paydowns of available for sale securities	501,653	902,938
Purchase of available for sale securities	(505,363)	(903,331)
Net change in total loans	(18,660)	(93,996)
Purchase of bank premises and equipment	(1,076)	(557)
Net purchases of Federal Home Loan Bank stock	(1,199)	(6,642)
Net cash used in investing activities	(24,645)	(101,588)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in noninterest-bearing deposits	11,770	21,474
Net increase in interest-bearing deposits	59,061	120,908
Paydowns on borrowed funds	(50,000)	(10,000)
Proceeds from the issuance of common stock, stock option exercises, restricted stock awards and the ESPP	988	2,147
Net cash provided by financing activities	21,819	134,529
NET CHANGE IN CASH AND CASH EQUIVALENTS	7,985	42,048
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	182,103	142,098
CASH AND CASH EQUIVALENTS, END OF PERIOD	$190,088	$184,146
SUPPLEMENTAL INFORMATION:		
Income taxes paid	$1,900	$—
Interest paid	4,900	3,421

See condensed notes to interim consolidated financial statements.

ALLEGIANCE BANCSHARES, INC.
CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2018
(Unaudited)

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

Nature of Operations-Allegiance Bancshares, Inc. (“Allegiance”) and its wholly-owned subsidiary, Allegiance Bank, (the “Bank”, and together with Allegiance, collectively referred to as the “Company”) provide commercial and retail loans and commercial banking services. The Company derives substantially all of its revenues and income from the operation of the Bank. The Company is focused on delivering a wide variety of relationship-driven commercial banking products and community-oriented services tailored to meet the needs of small to medium-sized businesses, professionals and individuals through its 16 offices and one loan production office in Houston, Texas and the surrounding region. The Bank provides its customers with a variety of banking services including checking accounts, savings accounts and certificates of deposit, and its primary lending products are commercial, personal, automobile, mortgage and home improvement loans. The Bank also offers safe deposit boxes, automated teller machines, drive-through services and 24-hour depository facilities.

Basis of Presentation-The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and in accordance with guidance provided by the Securities and Exchange Commission. Accordingly, the condensed consolidated financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments considered necessary for a fair presentation of the financial position, results of operations and cash flows of the Company on a consolidated basis, and all such adjustments are of a normal recurring nature. Transactions with Allegiance have been eliminated. The condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017. Operating results for the three months ended March 31, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018.

Significant Accounting and Reporting Policies

The Company’s significant accounting and reporting policies can be found in Note 1 of the Company’s annual financial statements included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

New Accounting Standards

Adoption of New Accounting Standards

ASU 2014-09 “Revenue from Contracts with Customers (Topic 606).” ASU 2014-09 supersedes the revenue recognition requirements in Revenue Recognition (Topic 605), and most industry-specific guidance throughout the Industry Topics of the Codification. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The Company records revenue from contracts with customers in accordance with Accounting Standards Codification Topic 606, “Revenue from Contracts with Customers” (“Topic 606”). Under Topic 606, the Company must identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the Company satisfies a performance obligation. Significant revenue has not been recognized in the current reporting period that results from performance obligations satisfied in previous periods. The Company’s primary sources of revenue are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of ASU 2014-09. The Company has evaluated the nature of its contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the Consolidated Statements of Income was not necessary. The Company generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed, charged either on a periodic basis or based on activity. Because performance obligations are satisfied as services are rendered and the transaction prices are fixed, there is little judgment

involved in applying Topic 606 that significantly affects the determination of the amount and timing of revenue from contracts with customers. The new standard was effective for the Company on January 1, 2018 and did not have a significant impact on its consolidated financial statements and related disclosures.
ASU No. 2016-01, "Financial Instruments - Overall (Subtopic 825-10): Recognition of Financial Assets and Financial Liabilities." ASU 2016-01 makes targeted amendments to fair value measurement and disclosure guidance. ASU 2016-01 requires equity investments (other than equity method investments) to be measured at fair value with changes in fair value recognized in net income. This change is only applied if a readily determinable fair value can be obtained. The update also requires the use of exit prices to measure fair value for disclosure purposes as well as other enhanced disclosure requirements. ASU 2016-01 was effective for the Company on January 1, 2018 and did not have a significant impact on its financial statements and related disclosures. See Note 5 – Fair Value Disclosures for further information.
ASU 2016-15, “Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments." ASU 2016-15 provides guidance related to certain cash flow issues in order to reduce the current and potential future diversity in practice. Among other things, the update clarifies the appropriate classification for proceeds from settlement of bank owned life insurance (BOLI) policies. Based on preliminary assessments, the Company expects to change the classification of proceeds from settlement of BOLI policies, if any, from operating activities to investing activities. ASU 2016-15 was effective for the Company on January 1, 2018 and did not have a significant impact on its financial statements and related disclosures.

ASU 2018-02, “Income Statement - Reporting Comprehensive Income (Topic 220) - Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.” ASU 2018-02 amends ASC 220, Income Statement - Reporting Comprehensive Income, to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. On December 22, 2017, the United States enacted tax reform legislation commonly known as the Tax Cuts and Jobs Act (the “Tax Act”), resulting in significant modifications to existing law. Authoritative guidance and interpretation by regulatory bodies is ongoing, and as such, the accounting for the effects of the Tax Act is not final and the full impact of the new regulation is still being evaluated. ASU 2018-02 is effective on January 1, 2019, with early adoption permitted. The Company early adopted and recognized a decrease to retained earnings of $72 thousand due to a reclassification on January 1, 2018.
Newly Issued But Not Yet Effective Accounting Standards

ASU 2016-02 “Leases (Topic 842)." ASU 2016-02 will, among other things, require lessees to recognize a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. ASU 2016-02 does not significantly change lease accounting requirements applicable to lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model and ASC Topic 606, “Revenue from Contracts with Customers.” ASU 2016-02 will be effective for the Company on January 1, 2019 and will require transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. Early application of this ASU is permitted for all entities. Adoption of ASU 2016-02 is not expected to have a material impact on the Company’s financial statements. The Company leases certain properties and equipment under operating leases that will result in the recognition of lease assets and lease liabilities on the Company’s balance sheet under the ASU.

ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” Among other things, ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better form their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, ASU 2016-13 amends the accounting for credit losses on available for sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 is effective for the Company on January 1, 2020 and must be applied using the modified retrospective approach with limited exceptions. Early adoption is permitted for fiscal years, and interim periods within those years, beginning after December 15, 2018. While the Company is currently unable to reasonably estimate the impact of adopting ASU 2016-13, the Company expects that the impact of adoption will be significantly influenced by the composition, characteristics and quality of its loan and securities portfolios as well as the

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prevailing economic conditions and forecasts as of the adoption date. The Company has formed a cross functional team and with the assistance of a third-party provider is assessing the Company's data and system needs to evaluate the impact that adoption of this standard will have on the financial condition and results of operations of the Company.

ASU No. 2017-04, “Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment,” ASU 2017-04 eliminates Step 2 from the goodwill impairment test which required entities to compute the implied fair value of goodwill. Under ASU 2017-04, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. ASU 2017-04 will be effective for the Company on January 1, 2020, with earlier adoption permitted and is not expected to have a significant impact on the Company's financial statements.

ASU 2017-08,“Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20) - Premium Amortization on Purchased Callable Debt Securities.” ASU 2017-08 shortens the amortization period for certain callable debt securities held at a premium to require such premiums to be amortized to the earliest call date unless applicable guidance related to certain pools of securities is applied to consider estimated prepayments. Under prior guidance, entities were generally required to amortize premiums on individual, non-pooled callable debt securities as a yield adjustment over the contractual life of the security. ASU 2017-08 does not change the accounting for callable debt securities held at a discount. ASU 2017-08 will be effective for the Company on January 1, 2019, with early adoption permitted. The Company is currently evaluating the potential impact of ASU 2017-08 on its financial statements.

2. GOODWILL AND CORE DEPOSIT INTANGIBLE ASSETS

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

	Goodwill	Core Deposit Intangibles
	(Dollars in thousands)	
Balance as of January 1, 2017	$39,389	$ 4,055
Amortization	—	(781)
Balance as of December 31, 2017	39,389	3,274
Amortization	—	(195)
Balance as of March 31, 2018	$39,389	$ 3,079

Goodwill is recorded on the acquisition date of an entity. Management performs an evaluation annually, and more frequently if a triggering event occurs, of whether any impairment of the goodwill and other intangible assets has occurred. If any such impairment is determined, a write-down is recorded. As of March 31, 2018, there were no impairments recorded on goodwill and other intangible assets.

The estimated aggregate future amortization expense for core deposit intangible assets remaining as of March 31, 2018 is as follows (dollars in thousands):

Remaining 2018	$586
2019	781
2020	744
2021	484
2022	484

Thereafter	—
Total	$3,079

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3. SECURITIES

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

	March 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
U.S. Government and agency securities	$8,299	$ 142	$ (59)	$8,382
Municipal securities	221,403	1,166	(4,281)	218,288
Agency mortgage-backed pass-through securities	36,197	74	(954)	35,317
Corporate bonds and other	46,077	—	(653)	45,424
Total	$311,976	$ 1,382	$ (5,947)	$307,411

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
U.S. Government and agency securities	$8,507	$ 232	$ (24)	$8,715
Municipal securities	222,330	2,470	(1,842)	222,958
Agency mortgage-backed pass-through securities	32,014	159	(361)	31,812
Corporate bonds and other	46,247	62	(179)	46,130
Total	$309,098	$ 2,923	$ (2,406)	$309,615

As of March 31, 2018, the Company's management does not expect to sell any securities classified as available for sale with material unrealized losses, and the Company believes it is more likely than not it will not be required to sell any of these securities before their anticipated recovery, at which time the Company will receive full value for the securities. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of March 31, 2018, management believes the unrealized losses in the previous table are temporary and no other than temporary impairment loss has been realized in the Company's consolidated statements of income.

The amortized cost and fair value of investment securities at March 31, 2018, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations at any time with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(Dollars in thousands)	
Due in one year or less	$11,873	$11,873
Due after one year through five years	71,990	71,051
Due after five years through ten years	92,765	91,478
Due after ten years	99,151	97,692
Subtotal	275,779	272,094

Agency mortgage-backed pass through securities	36,197	35,317
Total	$311,976	$307,411

ALLEGIANCE BANCSHARES, INC.
CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
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Securities with unrealized losses segregated by length of time such securities have been in a continuous loss position are as follows:

	March 31, 2018					
	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
	(Dollars in thousands)					
Available for Sale						
U.S. Government and agency securities	$3,342	$(34)	$531	$(25)	$3,873	$(59)
Municipal securities	100,904	(2,015)	55,389	(2,266)	156,293	(4,281)
Agency mortgage-backed pass-through securities	20,426	(507)	8,461	(447)	28,887	(954)
Corporate bonds and other	44,424	(653)	—	—	44,424	(653)
Total	$169,096	$(3,209)	$64,381	$(2,738)	$233,477	$(5,947)

	December 31, 2017					
	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
	(Dollars in thousands)					
Available for Sale						
U.S. Government and agency securities	$3,110	$(9)	$595	$(15)	$3,705	$(24)
Municipal securities	42,249	(517)	56,483	(1,325)	98,732	(1,842)
Agency mortgage-backed pass-through securities	13,238	(105)	8,921	(256)	22,159	(361)
Corporate bonds and other	30,203	(179)	—	—	30,203	(179)
Total	$88,800	$(810)	$65,999	$(1,596)	$154,799	$(2,406)

No securities were sold during the three months ended March 31, 2018 and 2017. At March 31, 2018 and December 31, 2017, the Company did not own securities of any one issuer, other than the U.S government and its agencies, in an amount greater than 10% of consolidated shareholders' equity at such respective dates.

The carrying value of pledged securities was $5.0 million at March 31, 2018 and $5.0 million at December 31, 2017, respectively. The securities are pledged to further collateralize letters of credit issued by the Bank but confirmed by another financial institution.

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ALLEGIANCE BANCSHARES, INC.
CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2018
(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES

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

	March 31, 2018	December 31, 2017
	(Dollars in thousands)	
Commercial and industrial	$447,168	$457,129
Mortgage warehouse	41,572	69,456
Real estate:		
Commercial real estate (including multi-family residential)	1,108,537	1,080,247
Commercial real estate construction and land development	257,566	243,389
1-4 family residential (including home equity)	317,842	301,219
Residential construction	108,882	109,116
Consumer and other	8,927	10,320
Total loans	2,290,494	2,270,876
Allowance for loan losses	(24,628)	(23,649)
Loans, net	$2,265,866	$2,247,227

Nonaccrual and Past Due Loans

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

	March 31, 2018					
	Loans Past Due and Still Accruing					
	30-89 Days	90 or More Days	Total Past Due Loans	Nonaccrual Loans	Current Loans	Total Loans
	(Dollars in thousands)					
Commercial and industrial	$1,545	$ —	$ 1,545	$ 6,153	$439,470	$447,168
Mortgage warehouse	—	—	—	—	41,572	41,572
Real estate:						
Commercial real estate (including multi-family residential)	699	—	699	6,466	1,101,372	1,108,537
Commercial real estate construction and land development	75	—	75	—	257,491	257,566
1-4 family residential (including home equity)	1,164	—	1,164	754	315,924	317,842
Residential construction	1,787	—	1,787	—	107,095	108,882
Consumer and other	25	—	25	—	8,902	8,927
Total loans	$5,295	$ —	$ 5,295	$ 13,373	$2,271,826	$2,290,494

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	December 31, 2017					
	Loans Past Due and Still Accruing					
	30-89 Days	90 or More Days	Total Past Due Loans	Nonaccrual Loans	Current Loans	Total Loans
	(Dollars in thousands)					
Commercial and industrial	$1,069	$ —	$ 1,069	$ 6,437	$449,623	$457,129
Mortgage warehouse	—	—	—	—	69,456	69,456
Real estate:						
Commercial real estate (including multi-family residential)	4,932	—	4,932	6,110	1,069,205	1,080,247
Commercial real estate construction and land development	5,274	—	5,274	—	238,115	243,389
1-4 family residential (including home equity)	924	—	924	781	299,514	301,219
Residential construction	674	—	674	—	108,442	109,116
Consumer and other	74	—	74	—	10,246	10,320
Total loans	$12,947	$ —	$ 12,947	$ 13,328	$2,244,601	$2,270,876

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Impaired Loans

Impaired loans by class of loans are set forth in the following tables.

	March 31, 2018		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in thousands)		
With no related allowance recorded:			
Commercial and industrial	$4,036	$ 4,519	$ —
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	10,940	10,941	—
Commercial real estate construction and land development	209	209	—
1-4 family residential (including home equity)	910	910	—
Residential construction	—	—	—
Consumer and other	—	—	—
Total	16,095	16,579	—
With an allowance recorded:			
Commercial and industrial	7,047	7,443	2,723
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	7,919	8,104	569
Commercial real estate construction and land development	—	—	—
1-4 family residential (including home equity)	—	—	—
Residential construction	—	—	—
Consumer and other	—	—	—
Total	14,966	15,547	3,292
Total:			
Commercial and industrial	11,083	11,962	2,723
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	18,859	19,045	569
Commercial real estate construction and land development	209	209	—
1-4 family residential (including home equity)	910	910	—
Residential construction	—	—	—
Consumer and other	—	—	—
	$31,061	$ 32,126	$ 3,292

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	December 31, 2017		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in thousands)		
With no related allowance recorded:			
Commercial and industrial	$5,792	$6,666	$ —
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	12,155	12,155	—
Commercial real estate construction and land development	209	209	—
1-4 family residential (including home equity)	948	948	—
Residential construction	—	—	—
Consumer and other	—	—	—
Total	19,104	19,978	—
With an allowance recorded:			
Commercial and industrial	5,600	5,652	1,640
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	8,009	8,194	716
Commercial real estate construction and land development	—	—	—
1-4 family residential (including home equity)	—	—	—
Residential construction	—	—	—
Consumer and other	—	—	—
Total	13,609	13,846	2,356
Total:			
Commercial and industrial	11,392	12,318	1,640
Mortgage warehouse	—	—	—
Real estate:			
Commercial real estate (including multi-family residential)	20,164	20,349	716
Commercial real estate construction and land development	209	209	—
1-4 family residential (including home equity)	948	948	—
Residential construction	—	—	—
Consumer and other	—	—	—
	$32,713	$33,824	$ 2,356

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The following table presents average impaired loans and interest recognized on impaired loans for the three months ended March 31, 2018 and 2017:

	Three Months Ended March 31,			
	2018		2017	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
Commercial and industrial	$11,461	$ 94	$15,742	$ 139
Mortgage warehouse	—	—	—	—
Real estate:				
Commercial real estate (including multi-family residential)	18,967	141	16,854	77
Commercial real estate construction and land development	209	3	72	—
1-4 family residential (including home equity)	927	4	575	1
Residential construction	—	—	—	—
Consumer and other	—	—	14	—
Total	$31,564	$ 242	$33,257	$ 217

Credit Quality Indicators

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt, including factors such as: current financial information, historical payment experience, credit documentation, public information and current economic trends. The Company analyzes loans individually by classifying the loans by credit risk. As part of the ongoing monitoring of the credit quality of the Company’s loan portfolio and methodology for calculating the allowance for credit losses, management assigns and tracks risk ratings to be used as credit quality indicators.

The following is a general description of the risk ratings used:

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

Watch—Loans classified as watch loans may still be of high quality, but have an element of risk added to the credit such as declining payment history, deteriorating financial position of the borrower or a decrease in collateral value.

Special Mention—Loans classified as special mention have a potential weakness that deserves management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution’s credit position at some future date. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Substandard—Loans classified as substandard have well-defined weaknesses on a continuing basis and are inadequately protected by the current net worth and paying capacity of the borrower, impaired or declining collateral values, or a continuing downturn in their industry which is reducing their profits to below zero and having a significantly negative impact on their cash flow. These classified loans are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful—Loans classified as doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values highly questionable and improbable.

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Based on the most recent analysis performed, the risk category of loans by class of loan at March 31, 2018 is as follows:

	Pass	Watch	Special Mention	Substandard	Doubtful	Total
	(Dollars in thousands)					
Commercial and industrial	$419,105	$10,115	$ 1,610	$ 16,338	$ —	$447,168
Mortgage warehouse	41,572	—	—	—	—	41,572
Real estate:						
Commercial real estate (including multi-family residential)	1,045,532	24,830	3,067	35,108	—	1,108,537
Commercial real estate construction and land development	245,815	4,345	—	7,406	—	257,566
1-4 family residential (including home equity)	311,603	3,024	1,278	1,937	—	317,842
Residential construction	104,987	3,895	—	—	—	108,882
Consumer and other	8,851	75	—	1	—	8,927
Total loans	$2,177,465	$46,284	$ 5,955	$ 60,790	$ —	$2,290,494

The following table presents the risk category of loans by class of loan at December 31, 2017:

	Pass	Watch	Special Mention	Substandard	Doubtful	Total
	(Dollars in thousands)					
Commercial and industrial	$427,336	$10,274	$ 2,195	$ 17,324	$ —	$457,129
Mortgage warehouse	69,456	—	—	—	—	69,456
Real estate:						
Commercial real estate (including multi-family residential)	1,016,831	23,039	4,685	35,692	—	1,080,247
Commercial real estate construction and land development	231,536	4,397	—	7,456	—	243,389
1-4 family residential (including home equity)	295,744	2,696	785	1,994	—	301,219
Residential construction	103,611	5,505	—	—	—	109,116
Consumer and other	10,207	111	—	2	—	10,320
Total loans	$2,154,721	$46,022	$ 7,665	$ 62,468	$ —	$2,270,876

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Allowance for Loan Losses
The following table presents the activity in the allowance for loan losses by portfolio type for the three months ended March 31, 2018 and 2017:

	Commercial and industrial	Mortgage warehouse	Commercial real estate (including multi-family residential)	Commercial real estate construction and land development	1-4 family residential (including home equity)	Residential construction	Consumer and other	Total
	(Dollars in thousands)							
Allowance for loan losses:								
Three Months Ended								
Balance December 31, 2017	$7,694	$ —	$ 10,253	$ 2,525	$ 2,140	$ 942	$ 95	$23,649
Provision for loan losses	1,440	—	(963)	20	160	4	(8)	653
Charge-offs	(367)	—	(40)	—	—	—	—	(407)
Recoveries	631	—	102	—	—	—	—	733
Net recoveries	264	—	62	—	—	—	—	326
Balance March 31, 2018	$9,398	$ —	$ 9,352	$ 2,545	$ 2,300	$ 946	$ 87	$24,628
Allowance for loan losses:								
Three Months Ended								
Balance December 31, 2016	$5,059	$ —	$ 8,950	$ 1,217	$ 1,876	$ 748	$ 61	$17,911
Provision for loan losses	806	—	208	391	(40)	(11)	(11)	1,343
Charge-offs	(627)	—	—	—	—	—	—	(627)
Recoveries	46	—	—	—	10	—	4	60
Net charge-offs	(581)	—	—	—	10	—	4	(567)
Balance March 31, 2017	$5,284	$ —	$ 9,158	$ 1,608	$ 1,846	$ 737	$ 54	$18,687

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The following table presents the balance of the allowance for loan losses by portfolio type based on the impairment method as of March 31, 2018 and December 31, 2017:

	Commercial and industrial	Mortgage warehouse	Commercial real estate (including multi-family residential)	Commercial real estate construction and land development	1-4 family residential (including home equity)	Residential construction	Consumer and other	Total
	(Dollars in thousands)							
Allowance for loan losses related to:								
March 31, 2018								
Individually evaluated for impairment	$2,723	$ —	$ 569	$ —	$ —	$ —	$ —	$3,292
Collectively evaluated for impairment	6,675	—	8,783	2,545	2,300	946	87	21,336
Total allowance for loan losses	$9,398	$ —	$ 9,352	$ 2,545	$ 2,300	$ 946	$ 87	$24,628
December 31, 2017								
Individually evaluated for impairment	$1,640	$ —	$ 716	$ —	$ —	$ —	$ —	$2,356
Collectively evaluated for impairment	6,054	—	9,537	2,525	2,140	942	95	21,293
Total allowance for loan losses	$7,694	$ —	$ 10,253	$ 2,525	$ 2,140	$ 942	$ 95	$23,649

The following table presents the recorded investment in loans held for investment by portfolio type based on the impairment method as of March 31, 2018 and December 31, 2017:

	Commercial and industrial	Mortgage warehouse	Commercial real estate (including multi-family residential)	Commercial real estate construction and land development	1-4 family residential (including home equity)	Residential construction	Consumer and other	Total
	(Dollars in thousands)							
Recorded investment in loans:								
March 31, 2018								
Individually evaluated for impairment	$11,083	$—	$18,859	$ 209	$910	$—	$—	$31,061
Collectively evaluated for impairment	436,085	41,572	1,089,678	257,357	316,932	108,882	8,927	2,259,433
Total loans evaluated for impairment	$447,168	$41,572	$1,108,537	$ 257,566	$317,842	$ 108,882	$ 8,927	$2,290,494
December 31, 2017								

Individually evaluated for impairment	$11,392	$—	$20,164	$209	$948	$—	$—	$32,713
Collectively evaluated for impairment	445,737	69,456	1,060,083	243,180	300,271	109,116	10,320	2,238,163
Total loans evaluated for impairment	$457,129	$69,456	$1,080,247	$243,389	$301,219	$109,116	$10,320	$2,270,876

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Troubled Debt Restructurings

As of March 31, 2018 and December 31, 2017, the Company had a recorded investment in troubled debt restructurings of $25.4 million and $25.6 million, respectively. The Company allocated $1.9 million and $2.2 million of specific reserves for troubled debt restructurings at March 31, 2018 and December 31, 2017, respectively, and did not commit to lend additional amounts on these loans.

The following tables present information regarding loans modified in a troubled debt restructuring during the three months ended March 31, 2018 and 2017:

	As of March 31,					
	2018			2017		
	Number of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification of Outstanding Recorded Investment	Number of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification of Outstanding Recorded Investment
	(Dollars in thousands)					
Troubled Debt Restructurings						
Commercial and industrial	6	337	337	1	316	316
Mortgage warehouse	—	—	—	—	—	—
Real estate:						
Commercial real estate (including multi-family residential)	—	—	—	1	1,328	1,328
Commercial real estate construction and land development	—	—	—	—	—	—
1-4 family residential (including home equity)	—	—	—	1	86	86
Residential construction	—	—	—	—	—	—
Consumer and other	—	—	—	—	—	—
Total	6	337	337	3	1,730	1,730

Troubled debt restructurings resulted in charge-offs of $17 thousand and $395 thousand during the three months ended March 31, 2018 and 2017, respectively.

As of March 31, 2018, there have been no defaults on any loans that were modified as troubled debt restructurings during the preceding 12 months. Default is determined at 90 or more days past due. The modifications primarily related to extending the amortization periods of the loans. The Company did not grant principal reductions on any restructured loans. There were no commitments to lend additional amounts for the three months ended March 31, 2018 and 2017. During the three months ended March 31, 2018, the Company added $337 thousand in new troubled debt restructurings, of which $314 thousand were still outstanding on March 31, 2018.

5. FAIR VALUE

The Company uses fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Fair value represents the exchange price that would be received from selling an asset or paid to transfer a liability, otherwise known as an “exit price,” in the principal or most advantageous market available to the entity in an orderly transaction between market participants on the measurement date.

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Fair Value Hierarchy

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company groups financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level 1—Quoted prices for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- Level 2—Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3—Significant unobservable inputs that reflect management's judgment and assumptions that market participants would use in pricing an asset or liability that are supported by little or no market activity.

The carrying amounts and estimated fair values of financial instruments that are reported on the balance sheet are as follows:

	As of March 31, 2018				
	Carrying	Estimated Fair Value			
	Amount	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)				
Financial assets					
Cash and cash equivalents	$190,088	$190,088	$—	$ —	$190,088
Available for sale securities	307,411	—	307,411	—	307,411
Loans held for investment, net of allowance	2,265,866	—	—	2,257,861	2,257,861
FHLB stock	14,128	N/A	N/A	N/A	N/A
Accrued interest receivable	10,521	2	2,060	8,459	10,521
Financial liabilities					
Deposits	$2,284,802	$—	$2,276,516	$ —	$2,276,516
Accrued interest payable	1,212	—	1,212	—	1,212
Borrowed funds	232,569	—	237,498	—	237,498
Subordinated debt and subordinated debentures	48,719	—	48,719	—	48,719

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	As of December 31, 2017				
	Carrying Amount	Estimated Fair Value Level 1	Level 2	Level 3	Total
	(Dollars in thousands)				
Financial assets					
Cash and cash equivalents	$182,103	$182,103	$—	$ —	$182,103
Available for sale securities	309,615	—	309,615	—	309,615
Loans held for investment, net of allowance	2,247,227	—	—	2,238,721	2,238,721
FHLB stock	12,862	N/A	N/A	N/A	N/A
Accrued interest receivable	12,194	3	3,296	8,895	12,194
Financial liabilities					
Deposits	$2,213,974	$—	$2,209,111	$ —	$2,209,111
Accrued interest payable	610	—	610	—	610
Borrowed funds	282,569	—	288,887	—	288,887
Subordinated debt and subordinated debentures	48,659	—	48,659	—	48,659

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

	As of March 31, 2018			
	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)			
Available for sale securities:				
U.S. Government and agency securities	$—	$8,382	$ —	$8,382
Municipal securities	—	218,288	—	218,288
Agency mortgage-backed pass-through securities	—	35,317	—	35,317
Corporate bonds and other	—	45,424	—	45,424
Total	$—	$307,411	$ —	$307,411

	As of December 31, 2017			
	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)			
Available for sale securities:				
U.S. Government and agency securities	$—	$8,715	$ —	$8,715
Municipal securities	—	222,958	—	222,958
Agency mortgage-backed pass-through securities	—	31,812	—	31,812
Corporate bonds and other	—	46,130	—	46,130
Total	$—	$309,615	$ —	$309,615

There were no liabilities measured at fair value on a recurring basis as of March 31, 2018 or December 31, 2017. There were no transfers between levels during the three months ended March 31, 2018 or 2017.

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis, but are subject to fair value adjustments in certain circumstances such as evidence of impairment.

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	As of March 31, 2018		
	Level 1	Level 2	Level 3
	(Dollars in thousands)		
Impaired loans:			
Commercial and industrial	$ —	$ —	$ 4,720
Commercial real estate (including multi-family residential)	—	—	7,535
Other real estate owned	—	—	365
	$ —	$ —	$ 12,620

	As of December 31, 2017		
	Level 1	Level 2	Level 3
	(Dollars in thousands)		
Impaired loans:			
Commercial and industrial	$ —	$ —	$ 4,012
Commercial real estate (including multi-family residential)	—	—	7,478
Other real estate owned	—	—	365
	$ —	$ —	$ 11,855

Impaired Loans with Specific Allocation of Allowance

During the three months ended March 31, 2018 and the year ended December 31, 2017, certain impaired loans were reevaluated and reported at fair value through a specific allocation of the allowance for loan losses. At March 31, 2018, the total reported fair value of impaired loans of $12.3 million based on collateral valuations utilizing Level 3 valuation inputs had a carrying value of $15.5 million that was reduced by specific allowance allocations totaling $3.3 million. At December 31, 2017, the total reported fair value of impaired loans of $11.5 million based on collateral valuations utilizing Level 3 valuation inputs had a carrying value of $13.8 million that was reduced by specific allowance allocations totaling $2.4 million.

Other Real Estate Owned

At March 31, 2018 and December 31, 2017, the balance of other real estate owned consisted of a $365 thousand foreclosed commercial real estate property recorded as a result of obtaining physical possession of the property. At March 31, 2018, there was no formal foreclosure in process on this other real estate owned.

6. DEPOSITS

Time deposits that meet or exceed the Federal Deposit Insurance Corporation Insurance limit of $250 thousand at March 31, 2018 and December 31, 2017 were $260.6 million and $227.4 million, respectively.

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

Within one year	$ 575,405
After one but within two years	112,102
After two but within three years	38,811
After three but within four years	36,764
After four but within five years	99,695
Total	$ 862,777

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The Company has $243.2 million and $314.8 million of brokered deposits as of March 31, 2018 and December 31, 2017, respectively; and there are no major concentrations of deposits with any one depositor at March 31, 2018 and December 31, 2017. Included in these amounts are reciprocal deposits that the Company has placed through the Certificates of Deposits Account Registry Service (CDARS) Network of $73.1 million and $68.4 million, at March 31, 2018 and December 31, 2017, respectively.

7. BORROWINGS AND BORROWING CAPACITY

The Company has an available line of credit with the Federal Home Loan Bank ("FHLB") of Dallas, which allows the Company to borrow on a collateralized basis. FHLB advances are used to manage liquidity as needed. The advances are secured by a blanket lien on certain loans. Maturing advances are replaced by drawing on available cash, making additional borrowings or through increased customer deposits. At March 31, 2018, the Company had a total borrowing capacity of $1.00 billion, of which $702.4 million was available and $298.9 million was outstanding. FHLB advances of $232.0 million were outstanding at March 31, 2018, at a weighted average interest rate of 1.91%. Letters of credit were $66.9 million at March 31, 2018, of which $7.1 million will expire in July 2018, $15.1 million will expire in August 2018, $7.0 million will expire in September 2018, $25.0 million will expire in October 2018, $6.1 million will expire in December 2018, $1.7 million will expire in January 2019, $3.1 million will expire in February 2019, $300 thousand will expire in December 2019 and $1.5 million will expire in January 2020.

In 2015, the Company borrowed an additional $18.0 million under its credit agreement with another financial institution, which was in addition to the $10.1 million of indebtedness incurred under the same credit agreement in 2014. The credit agreement matures in December 2021. The Company used the funds borrowed in 2015 to repay debt that F&M Bancshares, Inc. owed and used the funds borrowed in 2014 to pay off a previous borrowing with another financial institution that had been entered into during 2013 in conjunction with the acquisition of Independence Bank. In October 2015, the Company paid down $27.5 million of the credit agreement with a portion of the proceeds from the initial public offering of Allegiance common stock. The credit agreement includes certain restrictive covenants. At March 31, 2018, the Company believes it is in compliance with its debt covenants and had not been made aware of any noncompliance by the lender. The interest rate on the outstanding debt under the revolving credit agreement is the Prime rate minus 25 basis points, or 4.25%, at March 31, 2018, and is paid quarterly. Scheduled principal maturities are as follows (dollars in thousands):

Remaining 2018	$—
2019	—
2020	—
2021	569
Total	$569

8. SUBORDINATED DEBT

Junior Subordinated Debentures

On January 1, 2015, the Company acquired F&M Bancshares and assumed Farmers & Merchants Capital Trust II and Farmers & Merchants Capital Trust III. Each of these trusts is a capital or statutory business trust organized for the sole purpose of issuing trust securities and investing the proceeds in the Company's junior subordinated debentures. The preferred trust securities of each trust represent preferred beneficial interests in the assets of the respective trusts and are subject to mandatory redemption upon payment of the junior subordinated debentures held by the trust. The common securities of each trust are wholly owned by the Company. Each trust's ability to pay amounts due on the trust preferred securities is solely dependent upon the Company making payment on the related junior subordinated debentures. The debentures, which are the only assets of each trust, are subordinate and junior in right of payment to all of the Company's present and future senior indebtedness. The Company has fully and unconditionally guaranteed each trust's obligations under the trust securities issued by such trust to the extent not paid or made by such trust, provided such trust has funds available for such obligations.

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Under the provisions of each issue of the debentures, the Company has the right to defer payment of interest on the debentures at any time, or from time to time, for periods not exceeding five years. If interest payments on either issue of the debentures are deferred, the distributions on the applicable trust preferred securities and common securities will also be deferred.

The Company assumed the junior subordinated debentures with an aggregate original principal amount of $11.3 million and a carrying fair value at March 31, 2018 of $9.3 million. At acquisition, the Company recorded a discount of $2.5 million on the debentures. The difference between the carrying value and contractual balance will be recognized as a yield adjustment over the remaining term for the debentures. At March 31, 2018, the Company had $11.3 million outstanding in junior subordinated debentures issued to the Company's unconsolidated subsidiary trusts. The junior subordinated debentures are included in Tier 1 capital under current regulatory guidelines and interpretations.

A summary of pertinent information related to the Company's issues of junior subordinated debentures outstanding at March 31, 2018 is set forth in the table below:

Description	Issuance Date	Trust Preferred Securities Outstanding	Interest Rate(1)	Junior Subordinated Debt Owed to Trusts	Maturity Date(2)
(Dollars in thousands)					
Farmers & Merchants Capital Trust II	November 13, 2003	$ 7,500	3 month LIBOR + 3.00%	$ 7,732	November 8, 2033
Farmers & Merchants Capital Trust III	June 30, 2005	3,500	3 month LIBOR + 1.80%	3,609	July 7, 2035

(1) The 3-month LIBOR in effect as of March 31, 2018 was 2.1796%.
(2) All debentures are currently callable.

Subordinated Notes

In December 2017, the Bank completed the issuance, through a private placement, of $40.0 million aggregate principal amount of Fixed-to-Floating Rate Subordinated Notes (the "Notes") due December 15, 2027. The Notes were issued at a price equal to 100% of the principal amount, resulting in net proceeds to the Bank of $39.4 million. The Bank intends to use the net proceeds from the offering to support its growth and for general corporate purposes. The Notes are intended to qualify as Tier 2 capital for bank regulatory purposes.

The Notes bear a fixed interest rate of 5.25% per annum until (but excluding) December 15, 2022, payable semi-annually in arrears. From December 15, 2022, the Notes will bear a floating rate of interest equal to 3-Month LIBOR + 3.03% until the Notes mature on December 15, 2027, or such earlier redemption date, payable quarterly in arrears. The Notes will be redeemable by the Bank, in whole or in part, on or after December 15, 2022 or, in whole but not in part, upon the occurrence of certain specified tax events, capital events or investment company events. Any redemption will be at a redemption price equal to 100% of the principal amount of Notes being redeemed, plus accrued and unpaid interest, and will be subject to, and require, prior regulatory approval. The Notes are not subject to redemption at the option of the holders.

9. INCOME TAXES

The amount of the Company's federal and state income tax expense is influenced by the amount of pre-tax income, the amount of tax-exempt income and the amount of other nondeductible items. For the three months ended March 31, 2018 and 2017, income tax expense was $1.5 million, for both periods. The effective income tax rate for the three months ended March 31, 2018 and 2017 was 15.9% and 20.2%, respectively. The decrease in income tax expense and

the effective tax rate year over year was primarily attributable to the Tax Act enacted on December 22, 2017, which reduced the U.S. federal statutory income tax rate from 35% to 21% effective January 1, 2018.
Interest and penalties related to tax positions are recognized in the period in which they begin accruing or when the entity claims the position that does not meet the minimum statutory thresholds. The Company does not have any uncertain tax

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positions and does not have any interest and penalties recorded in the income statement for the three months ended March 31, 2018 and 2017. The Company is no longer subject to examination by the U.S. Federal Tax Jurisdiction for the years prior to 2014.

10. STOCK BASED COMPENSATION

During 2015, the Company's Board of Directors and shareholders approved the 2015 Amended and Restated Stock Awards and Incentive Plan (the "Plan") covering certain awards of stock-based compensation to key employees and directors of the Company. The Plan was amended in 2017 as the shareholders authorized a maximum aggregate number of shares of stock to be issued of 1,900,000, any or all of which may be issued through incentive stock options. The Company accounts for stock based employee compensation plans using the fair value-based method of accounting. The Company recognized total stock based compensation expense of $438 thousand and $341 thousand for the three months ended March 31, 2018 and 2017, respectively.

Stock Options

Options to purchase a total of 1,309,231 shares of Company stock have been granted as of March 31, 2018. Under the Plan, options are exercisable up to 10 years from the date of the grant and are fully vested 4 years after the date of grant. The fair value of stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model.

A summary of the activity in the stock option plan during the three months ended March 31, 2018 is set forth below:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
	(In thousands)		(In years)	(In thousands)
Options outstanding, January 1, 2018	775	$ 19.94	5.72	$ 13,718
Options granted	4	40.40		
Options exercised	(74)	12.94		
Options forfeited	(9)	29.10		
Options outstanding, March 31, 2018	696	$ 20.72	5.82	$ 12,850
Options vested and exercisable, March 31, 2018	475	$ 18.00	4.83	$ 10,043

Restricted Stock Awards

During the three months ended March 31, 2018, the Company issued 300 shares of restricted stock. The forfeiture restrictions on restricted stock shares generally lapse over a period of 4 years, and the shares are considered outstanding at the date of issuance. The Company accounts for restricted stock grants by recording the fair value of the grant on the award date as compensation expense over the vesting period.

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A summary of the activity of the nonvested shares of restricted stock during the three months ended March 31, 2018 is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
	(Shares in thousands)	
Nonvested share awards outstanding, January 1, 2018	41	$ 30.46
Share awards granted	—	40.40
Share awards vested	(10)	23.66
Unvested share awards forfeited	—	—
Nonvested share awards outstanding, March 31, 2018	31	$ 31.49

11. OFF-BALANCE SHEET ARRANGEMENTS, COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Company enters into various transactions, which, in accordance with accounting principles generally accepted in the United States, are not included in the Company's consolidated balance sheets. The Company enters into these transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and standby letters of credit, which involve to varying degrees elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The Company uses the same credit policies in making commitments and conditional obligations as it does for on balance sheet instruments.
The contractual amounts of financial instruments with off-balance sheet risk are as follows:

	March 31, 2018		December 31, 2017	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
	(Dollars in thousands)			
Commitments to extend credit	$254,424	$342,980	$369,573	$250,467
Standby letters of credit	15,212	1,725	15,445	1,725
Total	$269,636	$344,705	$385,018	$252,192

Commitments to make loans are generally made for an approval period of 120 days or fewer. As of March 31, 2018, the funded fixed rate loan commitments had interest rates ranging from 1.75% to 7.50% with a weighted average maturity and rate of 2.16 years and 5.01%, respectively.

Litigation

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

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12. REGULATORY CAPITAL MATTERS

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Capital adequacy guidelines, and for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities and certain off balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weightings and other factors. Failure to meet minimum capital requirements can cause regulators to initiate actions that, if undertaken, could have a direct material effect on the Company’s consolidated financial statements. The final rules implementing Basel Committee on Banking Supervision's capital guideline for U.S. Banks (Basel III Rules) became effective for the Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Starting in January 2016, the implementation of the capital conservation buffer was effective for the Company starting at the 0.625% level and increasing 0.625% each year thereafter, until it reaches 2.5% on January 1, 2019. Management believes as of March 31, 2018 and December 31, 2017 the Company and the Bank met all capital adequacy requirements to which they were then subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required.

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The following is a summary of the Company's and the Bank's actual and required capital ratios at March 31, 2018 and December 31, 2017:

	Actual		Minimum Required For Capital Adequacy Purposes		Minimum Required Plus Capital Conservation Buffer		To Be Categorized As Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)							
ALLEGIANCE BANCSHARES, INC. (Consolidated)								
As of March 31, 2018								
Total Capital (to risk weighted assets)	$346,474	13.72%	$201,989	8.00%	$249,330	9.875%	N/A	N/A
Common Equity Tier 1 Capital (to risk weighted assets)	273,127	10.82%	113,619	4.50%	160,960	6.375%	N/A	N/A
Tier I Capital (to risk weighted assets)	282,458	11.19%	151,492	6.00%	198,833	7.875%	N/A	N/A
Tier I Capital (to average tangible assets)	282,458	9.98 %	113,180	4.00%	113,180	4.000%	N/A	N/A
As of December 31, 2017								
Total Capital (to risk weighted assets)	$336,829	13.43%	$200,687	8.00%	$232,044	9.250%	N/A	N/A
Common Equity Tier 1 Capital (to risk weighted assets)	264,521	10.54%	112,886	4.50%	144,244	5.750%	N/A	N/A
Tier I Capital (to risk weighted assets)	273,825	10.92%	150,515	6.00%	181,872	7.250%	N/A	N/A
Tier I Capital (to average tangible assets)	273,825	9.84 %	111,274	4.00%	96,708	4.000%	N/A	N/A
ALLEGIANCE BANK								
As of March 31, 2018								
Total Capital (to risk weighted assets)	$340,358	13.49%	$201,890	8.00%	$249,208	9.875%	$ 252,362	10.00 %
Common Equity Tier 1 Capital (to risk weighted assets)	276,342	10.95%	113,563	4.50%	160,881	6.375%	164,035	6.50 %
Tier I Capital (to risk weighted assets)	276,342	10.95%	151,417	6.00%	198,735	7.875%	201,890	8.00 %
Tier I Capital (to average tangible assets)	276,342	9.77 %	113,132	4.00%	113,132	4.000%	141,415	5.00 %
As of December 31, 2017								
Total Capital (to risk weighted assets)	$331,872	13.24%	$200,596	8.00%	$231,939	9.250%	$ 250,745	10.00 %
Common Equity Tier 1 Capital (to risk weighted assets)	268,868	10.72%	112,835	4.50%	144,179	5.750%	162,985	6.50 %
Tier I Capital (to risk weighted assets)	268,868	10.72%	150,447	6.00%	181,790	7.250%	200,596	8.00 %
Tier I Capital (to average tangible assets)	268,868	9.67 %	111,230	4.00%	111,230	4.000%	139,037	5.00 %

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13. EARNINGS PER COMMON SHARE

Diluted earnings per common share is computed using the weighted-average number of common shares determined for the basic earnings per common share computation plus the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock using the treasury stock method. Outstanding stock options issued by the Company represent the only dilutive effect reflected in diluted weighted average shares. Restricted shares are considered outstanding at the date of grant, accounted for as participating securities and included in basic and diluted weighted average common shares outstanding.

	Three Months Ended March 31,			
	2018		2017	
	Amount	Per Share Amount	Amount	Per Share Amount
	(Amounts in thousands, except per share data)			
Net income attributable to common shareholders	$7,711		$6,047	
Basic:				
Weighted average common shares outstanding	13,262	$ 0.58	13,021	