SOUTHSIDE BANCSHARES INC
Form 10-Q
July 27, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018
OR
o 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: 0-12247
SOUTHSIDE BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

TEXAS	75-1848732
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1201 S. Beckham Avenue, Tyler, Texas	75701
(Address of principal executive offices)	(Zip Code)

903-531-7111
(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 x No o

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

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

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

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. o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x
The number of shares of the issuer’s common stock, par value $1.25, outstanding as of July 23, 2018 was 35,089,372 shares.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(in thousands, except share amounts)

	June 30, 2018	December 31, 2017
ASSETS		
Cash and due from banks	$78,534	$79,171
Interest earning deposits	138,685	111,541
Federal funds sold	14,850	7,980
Total cash and cash equivalents	232,069	198,692
Securities available for sale, at estimated fair value	2,037,994	1,538,755
Securities held to maturity, at carrying value (estimated fair value of $159,055 and $921,800, respectively)	164,276	909,506
FHLB stock, at cost	42,994	55,729
Equity investments	12,037	5,821
Loans held for sale	4,566	2,001
Loans:		
Loans	3,270,883	3,294,356
Less: Allowance for loan losses	(25,072)	(20,781)
Net loans	3,245,811	3,273,575
Premises and equipment, net	132,578	133,640
Goodwill	201,246	201,246
Other intangible assets, net	20,287	22,993
Interest receivable	27,100	28,491
Deferred tax asset, net	15,377	12,204
Bank owned life insurance	97,059	100,368
Other assets	16,779	15,076
Total assets	$6,250,173	$6,498,097
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Deposits:		
Noninterest bearing	$1,038,907	$1,037,401
Interest bearing	3,469,834	3,478,046
Total deposits	4,508,741	4,515,447
Federal funds purchased and repurchase agreements	8,287	9,498
FHLB borrowings	776,467	1,017,361
Subordinated notes, net of unamortized debt issuance costs	98,326	98,248
Trust preferred subordinated debentures, net of unamortized debt issuance costs	60,243	60,241
Unsettled trades to purchase securities	2,279	—
Other liabilities	44,020	43,162
Total liabilities	5,498,363	5,743,957
Off-balance-sheet arrangements, commitments and contingencies (Note 13)		
Shareholders’ equity:		

Common stock: ($1.25 par value, 80,000,000 shares authorized and 37,822,784 shares issued at June 30, 2018 and 40,000,000 shares authorized and 37,802,352 shares issued at December 31, 2017)	47,278	47,253
Paid-in capital	759,562	757,439
Retained earnings	48,843	32,851
Treasury stock, at cost (2,738,968 at June 30, 2018 and 2,802,019 at December 31, 2017)	(46,551)	(47,105)
Accumulated other comprehensive loss	(57,322)	(36,298)
Total shareholders' equity	751,810	754,140
Total liabilities and shareholders' equity	$6,250,173	$6,498,097

The accompanying notes are an integral part of these consolidated financial statements.

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)
(in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Interest income				
Loans	$39,301	$28,090	$78,131	$55,344
Investment securities – taxable	51	267	278	644
Investment securities – tax-exempt	6,353	6,157	12,734	12,711
Mortgage-backed securities	10,210	10,818	21,104	20,863
FHLB stock and equity investments	411	299	825	597
Other interest earning assets	471	378	919	738
Total interest income	56,797	46,009	113,991	90,897
Interest expense				
Deposits	8,581	5,138	16,032	9,419
FHLB borrowings	3,007	3,551	6,639	7,015
Subordinated notes	1,407	1,398	2,805	2,791
Trust preferred subordinated debentures	658	494	1,227	961
Other borrowings	33	4	44	7
Total interest expense	13,686	10,585	26,747	20,193
Net interest income	43,111	35,424	87,244	70,704
Provision for loan losses	1,281	1,346	5,016	2,444
Net interest income after provision for loan losses	41,830	34,078	82,228	68,260
Noninterest income				
Deposit services	6,261	5,255	12,440	10,369
Net (loss) gain on sale of securities available for sale	(332)	(75)	(1,159)	247
Gain on sale of loans	173	505	288	1,206
Trust income	1,931	899	3,691	1,789
Bank owned life insurance income	1,185	635	1,817	1,269
Brokerage services	506	682	956	1,229
Other	1,283	1,392	2,584	2,857
Total noninterest income	11,007	9,293	20,617	18,966
Noninterest expense				
Salaries and employee benefits	16,633	14,984	35,192	30,991
Occupancy expense	3,360	2,897	6,943	5,760
Acquisition expense	1,026	473	1,858	473
Advertising, travel & entertainment	775	548	1,460	1,131
ATM and debit card expense	243	889	589	1,816
Professional fees	952	1,050	2,022	1,989
Software and data processing expense	939	688	1,962	1,413
Telephone and communications	478	476	1,016	1,002
FDIC insurance	484	445	981	886
Amortization expense on intangibles	1,328	410	2,706	841
Other	3,056	2,677	6,212	5,093
Total noninterest expense	29,274	25,537	60,941	51,395

Income before income tax expense	23,563	17,834	41,904	35,831
Income tax expense	3,360	3,353	5,450	6,361
Net income	$20,203	$14,481	$36,454	$29,470
Earnings per common share – basic	$0.58	$0.49	$1.04	$1.01
Earnings per common share – diluted	$0.57	$0.49	$1.04	$1.00
Dividends paid per common share	$0.30	$0.28	$0.58	$0.53

The accompanying notes are an integral part of these consolidated financial statements.

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)
(in thousands)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Net income	$20,203	$14,481	$36,454	$29,470
Other comprehensive (loss) income:				
Securities available for sale and transferred securities:				
Change in net unrealized holding (losses) gains on available for sale securities during the period	(10,371)	13,221	(48,154)	18,106
Unrealized net gain on securities transferred from held to maturity to available for sale under the transition guidance enumerated in ASU 2017-12	—	—	11,881	—
Change in net unrealized losses on securities transferred from held to maturity to available for sale	—	—	401	—
Reclassification adjustment for net loss on equity investments, reclassified to retained earnings with adoption of ASU 2016-01	—	—	107	—
Reclassification adjustment for amortization related to available for sale and held to maturity debt securities	1,252	213	1,390	701
Reclassification adjustment for net loss (gain) on sale of available for sale securities, included in net income	332	75	1,159	(247)
Derivatives:				
Change in net unrealized gain (loss) on effective cash flow hedge interest rate swap derivatives	1,725	(1,768)	5,970	(1,848)
Change in net unrealized gains on interest rate swap derivatives terminated during the period	—	—	—	273
Reclassification adjustment from other comprehensive income (loss) related to derivatives designated as cash flow hedge	(331)	223	(458)	593
Pension plans:				
Amortization of net actuarial loss and prior service credit, included in net periodic benefit cost	618	414	1,091	803
Other comprehensive (loss) income, before tax	(6,775)	12,378	(26,613)	18,381
Income tax benefit (expense) related to items of other comprehensive income (loss)	1,423	(4,332)	5,589	(6,433)
Other comprehensive (loss) income, net of tax	(5,352)	8,046	(21,024)	11,948
Comprehensive income	$14,851	$22,527	$15,430	$41,418

The accompanying notes are an integral part of these consolidated financial statements.

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(UNAUDITED)
(in thousands, except share and per share data)

	Common Stock	Paid In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2016	$ 39,320	$ 535,240	$ 30,098	$ (47,891)	$ (38,493)	$ 518,274
Net income	—	—	29,470	—	—	29,470
Other comprehensive income	—	—	—	—	11,948	11,948
Issuance of common stock for dividend reinvestment plan (21,474 shares)	27	694	—	—	—	721
Stock compensation expense	—	913	—	—	—	913
Net issuance of common stock under employee stock plans (60,078 shares)	60	820	(49)	59	—	890
Cash dividends paid on common stock ($0.53 per share)	—	—	(15,151)	—	—	(15,151)
Stock dividend declared (719,515 shares)	899	24,061	(24,960)	—	—	—
Balance at June 30, 2017	$ 40,306	$ 561,728	$ 19,408	$ (47,832)	$ (26,545)	$ 547,065
Balance at December 31, 2017	$ 47,253	$ 757,439	$ 32,851	$ (47,105)	$ (36,298)	$ 754,140
Net income	—	—	36,454	—	—	36,454
Other comprehensive loss	—	—	—	—	(21,024)	(21,024)
Issuance of common stock for dividend reinvestment plan (20,432 shares)	25	695	—	—	—	720
Stock compensation expense	—	965	—	—	—	965
Net issuance of common stock under employee stock plans (63,051 shares)	—	463	(52)	554	—	965
Cash dividends paid on common stock ($0.58 per share)	—	—	(20,325)	—	—	(20,325)
Cumulative effect of ASU 2016-01	—	—	(85)	—	—	(85)
Balance at June 30, 2018	$ 47,278	$ 759,562	$ 48,843	$ (46,551)	$ (57,322)	$ 751,810

The accompanying notes are an integral part of these consolidated financial statements.

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOW
(UNAUDITED)
(in thousands)

	Six Months Ended June 30, 2018	2017
OPERATING ACTIVITIES:		
Net income	$36,454	$29,470
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and net amortization	7,078	4,846
Securities premium amortization (discount accretion), net	7,557	8,756
Loan (discount accretion) premium amortization, net	(1,712)	(677)
Provision for loan losses	5,016	2,444
Stock compensation expense	965	913
Deferred tax expense	2,438	17
Net loss (gain) on sale of securities available for sale	1,159	(247)
Net loss on premises and equipment	132	55
Gross proceeds from sales of loans held for sale	13,578	39,582
Gross originations of loans held for sale	(12,159)	(34,977)
Net loss (gain) on other real estate owned	258	(1)
Net change in:		
Interest receivable	1,391	1,963
Other assets	16,612	2,479
Interest payable	247	60
Other liabilities	(8,484)	(5,935)
Net cash provided by operating activities	70,530	48,748
INVESTING ACTIVITIES:		
Securities available for sale:		
Purchases	(195,005)	(272,410)
Sales	315,656	328,854
Maturities, calls and principal repayments	78,042	62,242
Securities held to maturity:		
Purchases	—	(1,521)
Maturities, calls and principal repayments	1,767	11,316
Proceeds from redemption of FHLB stock and other investments	13,377	114
Purchases of FHLB stock and other investments	(914)	(477)
Net loan paydowns (originations)	19,722	(54,362)
Purchases of premises and equipment	(5,154)	(3,926)
Proceeds from sales of premises and equipment	1,905	5
Proceeds from sales of other real estate owned	771	134
Proceeds from sales of repossessed assets	287	272
Net cash provided by investing activities	230,454	70,241

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOW
(UNAUDITED) (continued)
(in thousands)

	Six Months Ended June 30, 2018	2017
FINANCING ACTIVITIES:		
Net change in deposits	$(6,866)	$90,953
Net (decrease) increase in federal funds purchased and repurchase agreements	(1,211)	1,327
Proceeds from FHLB borrowings	1,718,000	1,631,476
Repayment of FHLB borrowings	(1,958,890)	(1,763,027)
Proceeds from stock option exercises	1,084	1,022
Cash paid to tax authority related to tax withholding on share-based awards	(119)	(132)
Proceeds from the issuance of common stock for dividend reinvestment plan	720	721
Cash dividends paid	(20,325)	(15,151)
Net cash used in financing activities	(267,607)	(52,811)
Net increase in cash and cash equivalents	33,377	66,178
Cash and cash equivalents at beginning of period	198,692	169,654
Cash and cash equivalents at end of period	$232,069	$235,832
SUPPLEMENTAL DISCLOSURES FOR CASH FLOW INFORMATION:		
Interest paid	$26,499	$20,134
Income taxes paid	$—	$5,500
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Loans transferred to other repossessed assets and real estate through foreclosure	$764	$263
Loans transferred from portfolio to held for sale	$3,984	$—
Transfer of held to maturity securities to available for sale securities	$743,421	$—
Adjustment to pension liability	$(1,091)	$(803)
Stock dividend (2.5% for 2017)	$—	$24,960
Unsettled trades to purchase securities	$(2,279)	$(24,883)

The accompanying notes are an integral part of these consolidated financial statements.

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting and Reporting Policies

Basis of Presentation

In this report, the words “the Company,” “we,” “us,” and “our” refer to the combined entities of Southside Bancshares, Inc. and its subsidiaries. The words “Southside” and “Southside Bancshares” refer to Southside Bancshares, Inc. The words “Southside Bank” and “the Bank” refer to Southside Bank. “Omni” refers to OmniAmerican Bancorp, Inc., a bank holding company, and its wholly-owned subsidiary, OmniAmerican Bank, acquired by Southside on December 17, 2014. “Diboll” refers to Diboll State Bancshares, Inc., a bank holding company and its wholly-owned subsidiary, First Bank & Trust East Texas, acquired by Southside on November 30, 2017.

The accompanying unaudited consolidated financial statements have been prepared in accordance with United States (“U.S.”) generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, not all information required by GAAP for complete financial statements is included in these interim statements. In the opinion of management, all adjustments necessary for a fair presentation of such financial statements have been included. Such adjustments consisted only of normal recurring items. The preparation of these consolidated financial statements in accordance with GAAP requires the use of management’s estimates. These estimates are subjective in nature and involve matters of judgment. Actual amounts could differ from these estimates.

Interim results are not necessarily indicative of results for a full year. These financial statements should be read in conjunction with the financial statements and notes thereto in our Annual Report on Form 10-K for the year ended December 31, 2017.

Accounting Changes and Reclassifications

Certain prior period amounts have been reclassified to conform to current year presentation.

We adopted Accounting Standards Update (“ASU”) 2014-09, “Revenue from Contracts with Customers (Topic 606)” as modified by subsequently issued ASUs 2015-14, 2016-08, 2016-10, 2016-12 and 2016-20, on January 1, 2018, the effective date of the guidance, using the modified retrospective approach. As the majority of the Company’s revenues are not subject to the new guidance, the adoption of ASU 2014-09 did not have a material impact on the Company’s consolidated financial position, results of operations, equity or cash flows. We did adjust the presentation of revenue received from our brokerage services, merchant services, as well as our interchange income associated with debit card services, which were all deemed to be services offered in an agent capacity. These lines of revenue will now be presented on a net basis with the fee income disclosed net of the related costs in the noninterest income section of the consolidated statements of income. In connection with the adoption, for the three and six months ended June 30, 2018, we netted $988,000 and $1.8 million of debit card expense against deposit services income and $151,000 and $302,000 of brokerage expense against brokerage income, respectively. Due to the implementation of the guidance under the modified retrospective method, prior periods have not been adjusted and are not comparative. Refer to our revenue recognition discussion below and “Note 1 - Summary of Significant Accounting and Reporting Policies” in our Annual Report on Form 10-K for the year ended December 31, 2017 for more information related to our revenue recognition policies.

We adopted ASU 2016-01, “Financial Instruments – Overall (Subtopic 825-10) – Recognition and Measurement of Financial Assets and Financial Liabilities,” on January 1, 2018, the effective date of the guidance. ASU 2016-01, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (vii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available for sale ("AFS") securities in combination with the entity's other deferred tax assets. The guidance requires companies to apply the requirements in the year of adoption, through cumulative adjustment, while the guidance related to equity securities without readily determinable fair values should be applied prospectively. Adoption of this guidance resulted in a cumulative adjustment to retained earnings of $85,000, net of tax, on January 1, 2018 and an equity security with a carrying value of $5.9 million that was previously recognized in securities AFS, at estimated fair value on our consolidated balance sheet to instead be recognized in equity investments, with subsequent changes in fair value being recognized in income. Also in conjunction with the adoption, our fair value measurement of financial instruments will be based upon an exit price notion as required in ASC 820. The guidance was applied on a prospective approach resulting in prior periods no longer being comparable.

We adopted ASU 2017-07, "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost," on January 1, 2018. ASU 2017-07 requires employers to present the service cost component of net periodic postretirement benefit cost in the same income statement line item as other employee compensation costs arising from services rendered during the period. Employers are required to present the other components of the net periodic benefit cost separately from the line item that includes the service cost and outside of any subtotal of operating income, if one is presented. The guidance requires companies to apply the requirements retrospectively to all prior periods presented. We elected to use the practical expedient that permits us to use the amounts in our pension plan disclosures in our employee benefit footnote for the prior comparative periods as the estimation basis for applying the retrospective presentation requirements, which resulted in an increase of $69,000 and $157,000 in salaries and employee benefits expense and a decrease of $69,000 and $157,000 in other noninterest expense for the three and six months ended June 30, 2017, respectively.

We early adopted ASU 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities," on January 1, 2018. ASU 2017-12 (i) expands hedge accounting for nonfinancial and financial risk components and amends measurement methodologies to more closely align hedge accounting with a company's risk management activities, (ii) decreases the complexity of preparing and understanding hedge results by eliminating the separate measurement and reporting of hedge ineffectiveness, (iii) enhances transparency, comparability, and understanding of hedge results through enhanced disclosures and changing the presentation of hedge results to align the effects of the hedging instrument and the hedged item, and (iv) reduces the cost and complexity of applying hedge accounting by simplifying the manner in which assessments of hedge effectiveness may be performed. The guidance also permits a transition election to reclassify held to maturity ("HTM") securities to AFS securities if a portion of those securities would qualify to be hedged under the new "last-of-layer" approach. The guidance requires companies to apply the requirements to existing hedging relationships on the date of adoption, and the effect of the adoption should be reflected as of the beginning of the fiscal year of adoption. The guidance did not have an impact on our derivatives that qualified as hedges on the date of adoption and thus no adjustment was made to retained earnings. In conjunction with the adoption of ASU 2017-12, we made the transition election to reclassify approximately $743.4 million in book value of securities from HTM to AFS that qualified for the last-of-layer method described in ASU 2017-12.

During the three months ended June 30, 2018, we entered into partial term fair value hedges, as allowed under the recently adopted ASU 2017-12, for certain of our fixed rate callable AFS municipal securities. These hedges are expected to be effective in offsetting changes in the fair value of the hedged securities. Gains and losses on derivative instruments designated as fair value hedges, as well as the change in fair value on the hedged item, are recorded in interest income in the consolidated statements of income.

Revenue Recognition

Our revenue consists of net interest income on financial assets and financial liabilities and noninterest income. The classifications of our revenue are presented in the consolidated statements of income. On January 1, 2018, we adopted ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)" using the modified retrospective method. The revenue recognition principle in ASU 2014-09 is that an entity should recognize revenue to depict the transfer of 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.

ASU 2014-09 permits an entity to recognize the incremental costs of obtaining a contract as an expense when incurred if the amortization period of the asset would have been one year or less. We generally expense sales commissions when incurred because the amortization period is within one year or less. These costs are recorded within salaries and employee benefits on the consolidated statements of income.

Revenue is recognized when obligations under the terms of a contract with our customer are satisfied; generally this occurs with the transfer of control of goods or services. Under ASU 2014-09's practical expedient to recognize revenue equal to the amounts for which we have a right to invoice, revenue is measured as the amount of consideration we

expect to receive in exchange for the transfer of those goods or services.
The following summarizes our revenue recognition policies as they relate to revenue from contracts with customers under ASU 2014-09:

- Deposit services. Service charges on deposit accounts include fees for banking services provided, overdrafts and non-sufficient funds. Revenue is generally recognized in accordance with published deposit account agreements for retail accounts or contractual agreements for commercial accounts. Our deposit services also include our ATM and debit card interchange revenue that is presented net of the associated costs. Interchange revenue is generated by our deposit customers' usage and volume of activity. Interchange rates are not controlled by the Company, which effectively acts as processor that collects and remits payments associated with customer debit card transactions.

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- Trust income. Trust income includes fees and commissions from investment management, administrative and advisory services primarily for individuals, and to a lesser extent, partnerships and corporations. Revenue is recognized on an accrual basis at the time the services are performed and when we have a right to invoice and are based on either the market value of the assets managed or the services provided.
- Brokerage services. Brokerage services income includes fees and commissions charged when we arrange for another party to transfer brokerage services to a customer. The fees and commissions under this agent relationship are based upon stated fee schedules based upon the type of transaction, volume, and value of the services provided.
- Other noninterest income. Other noninterest income includes among other things, merchant services income. Merchant services revenue is derived from third party vendors that process credit card transactions on behalf of our merchant customers. Merchant services revenue is primarily comprised of residual fee income based on the referred merchant's processing volumes and/or margin.

Securities

Available for Sale ("AFS"). Debt securities that will be held for indefinite periods of time, including securities that may be sold in response to changes in market interest or prepayment rates, needs for liquidity and changes in the availability of and the yield on alternative investments are classified as AFS. These assets are carried at fair value with changes recorded in other comprehensive income. Fair value is determined using quoted market prices as of the close of business on the balance sheet date. If quoted market prices are not available, fair values are based on quoted market prices for similar securities or estimates from independent pricing services. Securities that are hedged with qualifying derivatives are carried at fair value with the change in fair value on both the hedged instrument and the securities recorded in interest income in the consolidated statements of income.

Held to Maturity ("HTM"). Debt securities that management has the positive intent and ability to hold until maturity are classified as HTM and are carried at their remaining unpaid principal balance, net of unamortized premiums or unaccreted discounts.

Equity Investments. Beginning January 1, 2018, upon adoption of ASU 2016-01, equity investments with readily determinable fair values are stated at fair value with unrealized gains and losses reported in income. For periods prior to January 1, 2018, certain equity investments were classified as AFS and stated at fair value with unrealized gains and losses reported as a separate component of accumulated other comprehensive income ("AOCI"), net of tax. Equity investments without readily determinable fair values are recorded at cost less impairment, if any.

Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." ASU 2016-02 requires a lessee to recognize assets and liabilities for leases with lease terms of more than 12 months. Consistent with current GAAP, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. However, unlike current GAAP which requires only capital leases to be recognized on the balance sheet, the new ASU 2016-02 will require both finance (formerly known as "capital") and operating leases to be recognized on the balance sheet. ASU 2016-02 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. The guidance requires companies to apply the requirements in the year of adoption using a modified retrospective approach. We are currently evaluating the impact this guidance will have on our consolidated financial statements, and we anticipate our assessment to be completed during the fiscal year 2018.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." ASU 2016-13 introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments. ASU 2016-13 also modifies the impairment model for AFS debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination. ASU 2016-13 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The guidance requires companies to apply the requirements in the year of adoption through cumulative adjustment with some aspects of the update requiring a prospective transition approach. We are currently evaluating the potential impact of the pending adoption of ASU 2016-13 on our consolidated financial statements. We plan to adopt on January 1, 2020, the effective date. We have developed a project plan and have assigned a project team to complete the analysis needed to implement the guidance. The team is currently completing the gap analysis/data collection and anticipates running parallel models in early 2019.

In January 2017, the FASB issued ASU 2017-04, “Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.” ASU 2017-04 is intended to simplify goodwill impairment testing by eliminating the second step of the analysis which requires the calculation of the implied fair value of goodwill to measure a goodwill impairment charge. The update requires entities to compare the fair value of a reporting unit with its carrying amount and recognize an impairment charge for any amount by which the carrying amount exceeds the reporting unit’s fair value, to the extent that the loss recognized does not exceed the amount of goodwill allocated to that reporting unit. ASU 2017-04 is effective for annual and interim goodwill impairment tests performed in periods beginning after December 15, 2019. Early adoption is permitted for annual and interim goodwill impairment

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testing dates after January 1, 2017. The guidance requires companies to apply the requirements prospectively in the year of adoption. ASU 2017-04 is not expected to have a significant impact on our consolidated financial statements.
In March 2017, the FASB issued ASU 2017-08, "Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities." Under current GAAP, premiums on callable debt securities are generally amortized over the contractual life of the security. ASU 2017-08 requires the premium on callable debt securities to be amortized to the earliest call date. If the debt security is not called at the earliest call date, the holder of the debt security would be required to reset the effective yield on the debt security based on the payment terms required by the debt security. ASU 2017-08 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. We have elected to adopt on January 1, 2019. The guidance requires companies to apply the requirements on a modified retrospective basis through a cumulative adjustment directly to retained earnings as of the beginning of the period of adoption. We have evaluated an estimate of the potential impact of the pending adoption of ASU 2017-08 on our consolidated financial statements. Based on our existing municipal securities portfolio, we believe the change to amortizing premiums to the earliest call date will increase amortization expense recorded through interest income for the year ended December 31, 2019 by approximately $3.4 million, net of tax.

2. Acquisition

On November 30, 2017, we acquired 100% of the outstanding stock of Diboll State Bancshares, Inc. and its wholly-owned subsidiary First Bank & Trust East Texas (collectively, "Diboll") headquartered in Diboll, Texas. Diboll operated 17 banking offices in Diboll and surrounding areas. We acquired Diboll to further expand our presence in the East Texas market. The operations of Diboll were merged into the Company as of the date of the acquisition.
The Diboll acquisition was accounted for using the acquisition method of accounting and accordingly, purchased assets, including identifiable intangible assets and assumed liabilities were recorded at their respective acquisition date fair values. The purchase price allocation is preliminary and is subject to final determination and valuation of the fair value of assets acquired and liabilities assumed. As of December 31, 2017, the Company recognized $109.7 million in initial goodwill associated with the Diboll acquisition. Our consolidated goodwill totaled $201.2 million as of June 30, 2018 and December 31, 2017. For more information concerning the fair value of the assets acquired and liabilities assumed in relation to the acquisition of Diboll, see "Note 2 - Acquisition" in our Annual Report on Form 10-K for the year ended December 31, 2017.

3. Earnings Per Share

Earnings per share on a basic and diluted basis are calculated as follows (in thousands, except per share amounts).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Basic and Diluted Earnings:				
Net income	$20,203	$14,481	$36,454	$29,470
Basic weighted-average shares outstanding	35,062	29,318	35,042	29,303
Add: Stock awards	171	201	175	208
Diluted weighted-average shares outstanding	35,233	29,519	35,217	29,511
Basic Earnings Per Share:				
Net Income	$0.58	$0.49	$1.04	$1.01
Diluted Earnings Per Share:				
Net Income	$0.57	$0.49	$1.04	$1.00

For the three- and six-month periods ended June 30, 2018, there were approximately 53,000 and 47,000 anti-dilutive shares, respectively. For the three- and six-month periods ended June 30, 2017, there were approximately 52,000 and 51,000 anti-dilutive shares, respectively.

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4. Accumulated Other Comprehensive Income (Loss)

The changes in accumulated other comprehensive income (loss) by component are as follows (in thousands):

	Three Months Ended June 30, 2018				
			Pension Plans		
	Unrealized Gains (Losses) on Securities	Unrealized Gains (Losses) on Derivatives	Net Prior Service (Cost) Credit	Net Gain (Loss)	Total
Beginning balance, net of tax	$(35,594)	$ 9,652	$(134)	$(25,894)	$(51,970)
Other comprehensive income (loss):					
Other comprehensive (loss) income before reclassifications	(10,371)	1,725	—	—	(8,646)
Reclassified from accumulated other comprehensive income	1,584	(331)	(2)	620	1,871
Income tax benefit (expense)	1,845	(293)	1	(130)	1,423
Net current-period other comprehensive (loss) income, net of tax	(6,942)	1,101	(1)	490	(5,352)
Ending balance, net of tax	$(42,536)	$ 10,753	$(135)	$(25,404)	$(57,322)

	Six Months Ended June 30, 2018				
			Pension Plans		
	Unrealized Gains (Losses) on Securities	Unrealized Gains (Losses) on Derivatives	Net Prior Service (Cost) Credit	Net Gain (Loss)	Total
Beginning balance, net of tax	$(16,295)	$ 6,399	$(133)	$(26,269)	$(36,298)
Other comprehensive income (loss):					
Other comprehensive (loss) income before reclassifications	(35,872)	5,970	—	—	(29,902)
Reclassified from accumulated other comprehensive income (1)	2,656	(458)	(4)	1,095	3,289
Income tax benefit (expense)	6,975	(1,158)	2	(230)	5,589
Net current-period other comprehensive (loss) income, net of tax	(26,241)	4,354	(2)	865	(21,024)
Ending balance, net of tax	$(42,536)	$ 10,753	$(135)	$(25,404)	$(57,322)

(1) As discussed in “Note 1 – Summary of Significant Accounting and Reporting Policies,” the Company adopted ASU 2016-01 on January 1, 2018. This amount includes a reclassification for the cumulative adjustment to retained earnings of $107,000 ($85,000, net of tax).

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	Three Months Ended June 30, 2017				
	Unrealized Gains (Losses) on Securities	Unrealized Gains (Losses) on Derivatives	Pension Plans Net Prior Service (Cost) Credit	Net Gain (Loss)	Total
Beginning balance, net of tax	$(20,425)	$ 4,961	$(134)	$(18,993)	$(34,591)
Other comprehensive income (loss):					
Other comprehensive income (loss) before reclassifications	13,221	(1,768)	—	—	11,453
Reclassified from accumulated other comprehensive income	288	223	(2)	416	925
Income tax (expense) benefit	(4,728)	541	—	(145)	(4,332)
Net current-period other comprehensive income (loss), net of tax	8,781	(1,004)	(2)	271	8,046
Ending balance, net of tax	$(11,644)	$ 3,957	$(136)	$(18,722)	$(26,545)

	Six Months Ended June 30, 2017				
	Unrealized Gains (Losses) on Securities	Unrealized Gains (Losses) on Derivatives	Pension Plans Net Prior Service (Cost) Credit	Net Gain (Loss)	Total
Beginning balance, net of tax	$(23,708)	$ 4,595	$(133)	$(19,247)	$(38,493)
Other comprehensive income (loss):					
Other comprehensive income (loss) before reclassifications	18,106	(1,575)	—	—	16,531
Reclassified from accumulated other comprehensive income	454	593	(4)	807	1,850
Income tax (expense) benefit	(6,496)	344	1	(282)	(6,433)
Net current-period other comprehensive income (loss), net of tax	12,064	(638)	(3)	525	11,948
Ending balance, net of tax	$(11,644)	$ 3,957	$(136)	$(18,722)	$(26,545)

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The reclassifications out of accumulated other comprehensive income (loss) into net income are presented below (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Unrealized losses on securities transferred:				
Amortization of unrealized losses [(1)]	$(1,252)	$(213)	$(1,390)	$(701)
Tax benefit	263	75	292	245
Net of tax	$(989)	$(138)	$(1,098)	$(456)
Unrealized gains and losses on available for sale securities:				
Realized net (loss) gain on sale of securities [(2)]	$(332)	$(75)	$(1,159)	$247
Tax benefit (expense)	70	26	243	(86)
Net of tax	$(262)	$(49)	$(916)	$161
Derivatives:				
Realized net gain (loss) on interest rate swap derivatives [(3)]	$309	$(245)	$415	$(624)
Tax (expense) benefit	(65)	86	(87)	218
Net of tax	$244	$(159)	$328	$(406)
Amortization of unrealized gains on terminated interest rate swap derivatives [(3)]	$22	$22	$43	$31
Tax expense	(5)	(8)	(9)	(11)
Net of tax	$17	$14	$34	$20
Amortization of pension plan:				
Net actuarial loss [(4)]	$(620)	$(416)	$(1,095)	$(807)
Prior service credit [(4)]	2	2	4	4
Total before tax	(618)	(414)	(1,091)	(803)
Tax benefit	129	145	228	281
Net of tax	(489)	(269)	(863)	(522)
Total reclassifications for the period, net of tax	$(1,479)	$(601)	$(2,515)	$(1,203)

(1) Included in interest income on the consolidated statements of income.
(2) Listed as net (loss) gain on sale of securities available for sale on the consolidated statements of income.
(3) Included in interest expense for FHLB borrowings on the consolidated statements of income.
(4) These accumulated other comprehensive income components are included in the computation of net periodic pension cost (income) presented in “Note 8 - Employee Benefit Plans.”

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5. Securities

Debt securities

The amortized cost, gross unrealized gains and losses, and estimated fair value of investment and mortgage-backed securities available for sale and held to maturity as of June 30, 2018 and December 31, 2017 are reflected in the tables below (in thousands):

	June 30, 2018			
AVAILABLE FOR SALE	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Investment Securities:				
State and Political Subdivisions	$806,824	$ 7,064	$ 17,880	$796,008
Other Stocks and Bonds	3,000	32	—	3,032
Mortgage-backed Securities: (1)				
Residential	714,270	2,394	17,626	699,038
Commercial	551,945	522	12,551	539,916
Total	$2,076,039	$ 10,012	$ 48,057	$2,037,994
HELD TO MATURITY				
Investment Securities:				
State and Political Subdivisions	$3,202	$ —	$ 40	$3,162
Mortgage-backed Securities: (1)				
Residential	60,080	181	2,194	58,067
Commercial	100,994	128	3,296	97,826
Total	$164,276	$ 309	$ 5,530	$159,055

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	December 31, 2017			
AVAILABLE FOR SALE	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Investment Securities:				
U.S. Government Agency Debentures	$108,869	$ —	$ —	$108,869
State and Political Subdivisions	392,760	3,895	3,991	392,664
Other Stocks and Bonds	5,024	31	—	5,055
Other Equity Securities (2)	6,027	—	107	5,920
Mortgage-backed Securities: (1)				
Residential	720,930	4,476	7,377	718,029
Commercial	308,357	761	900	308,218
Total	$1,541,967	$ 9,163	$ 12,375	$1,538,755
HELD TO MATURITY				
Investment Securities:				
State and Political Subdivisions	$413,632	$ 10,879	$ 2,583	$421,928
Mortgage-backed Securities: (1)				
Residential	129,044	1,631	239	130,436
Commercial	366,830	3,812	1,206	369,436
Total	$909,506	$ 16,322	$ 4,028	$921,800

(1) All mortgage-backed securities issued and/or guaranteed by U.S. government agencies or U.S. government-sponsored enterprises.
(2) See "Note 1 – Summary of Significant Accounting and Reporting Policies" for further information.

From time to time, we have transferred securities from AFS to HTM due to overall balance sheet strategies. The remaining net unamortized, unrealized loss on the transferred securities included in AOCI in the accompanying balance sheets totaled $15.6 million ($12.4 million, net of tax) at June 30, 2018 and $17.4 million ($13.8 million, net of tax) at December 31, 2017. Any net unrealized gain or loss on the transferred securities included in AOCI at the time of transfer will be amortized over the remaining life of the underlying security as an adjustment to the yield on those securities. Securities transferred with losses included in AOCI continue to be included in management's assessment for other-than-temporary impairment for each individual security. There were no securities transferred from AFS to HTM during the six months ended June 30, 2018 or the year ended December 31, 2017.
On January 1, 2018, we early-adopted ASU 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities," and in conjunction with the adoption took the one-time transition election to reclassify approximately $743.4 million book value of securities from HTM to AFS that qualified for hedging under the last-of-layer approach. The unrealized gain of $11.9 million ($9.4 million, net of tax) on the transferred securities was recognized in other comprehensive income on the date of transfer.

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The following tables represent the estimated fair value and unrealized loss on investment and mortgage-backed securities AFS and HTM as of June 30, 2018 and December 31, 2017 (in thousands):

	As of June 30, 2018					
	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
AVAILABLE FOR SALE						
Investment Securities:						
State and Political Subdivisions	$285,278	$ 5,260	$226,698	$ 12,620	$511,976	$ 17,880
Mortgage-backed Securities:						
Residential	518,512	10,797	107,118	6,829	625,630	17,626
Commercial	457,975	11,548	12,605	1,003	470,580	12,551
Total	$1,261,765	$ 27,605	$346,421	$ 20,452	$1,608,186	$ 48,057
HELD TO MATURITY						
Investment Securities:						
State and Political Subdivisions	$2,671	$ 40	$—	$ —	$2,671	$ 40
Mortgage-backed Securities:						
Residential	53,097	2,009	2,243	185	55,340	2,194
Commercial	77,355	2,155	11,964	1,141	89,319	3,296
Total	$133,123	$ 4,204	$14,207	$ 1,326	$147,330	$ 5,530

	As of December 31, 2017					
	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
AVAILABLE FOR SALE						
Investment Securities:						
State and Political Subdivisions	$32,341	$ 121	$172,006	$ 3,870	$204,347	$ 3,991
Other Equity Securities (1)	5,920	107	—	—	5,920	107
Mortgage-backed Securities:						
Residential	429,742	3,232	102,973	4,145	532,715	7,377
Commercial	146,796	419	13,134	481	159,930	900
Total	$614,799	$ 3,879	$288,113	$ 8,496	$902,912	$ 12,375
HELD TO MATURITY						
Investment Securities:						
State and Political Subdivisions	$85,608	$ 807	$56,736	$ 1,776	$142,344	$ 2,583
Mortgage-backed Securities:						
Residential	24,707	157	2,736	82	27,443	239
Commercial	136,491	782	13,552	424	150,043	1,206
Total	$246,806	$ 1,746	$73,024	$ 2,282	$319,830	$ 4,028

(1) See “Note 1 – Summary of Significant Accounting and Reporting Policies” for further information.

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We review those securities in an unrealized loss position for significant differences between fair value and the cost basis to evaluate if a classification of other-than-temporary impairment is warranted. In estimating other-than-temporary impairment losses, management considers, among other things, the length of time and the extent to which the fair value has been less than cost and the financial condition and near-term prospects of the issuer. We consider an other-than-temporary impairment to have occurred when there is an adverse change in expected cash flows. When it is determined that a decline in fair value of AFS and HTM securities is other-than-temporary, the carrying value of the security is reduced to its estimated fair value, with a corresponding charge to earnings for the credit portion and a charge to other comprehensive income for the noncredit portion. Based upon the length of time and the extent to which fair value is less than cost, we believe that none of the securities with an unrealized loss have other-than-temporary impairment at June 30, 2018.

The majority of the securities in an unrealized loss position are highly rated Texas municipal securities and U.S. Agency mortgage-backed securities ("MBS") where the unrealized loss is a direct result of the change in interest rates and spreads. For those securities in an unrealized loss position, we do not currently intend to sell the securities and it is not more likely than not that we will be required to sell the securities before the anticipated recovery of their amortized cost basis. To the best of management's knowledge and based on our consideration of the qualitative factors associated with each security, there were no securities in our investment and MBS portfolio with an other-than-temporary impairment at June 30, 2018.

Interest income recognized on securities for the periods presented (in thousands):

	Three Months Ended June 30,	
	2018	2017
U.S. Treasury	$23	$204
U.S. Government Agency Debentures	—	—
State and Political Subdivisions	6,353	6,157
Other Stocks and Bonds	28	35
Other Equity Securities	—	28
Mortgage-backed Securities	10,210	10,818
Total interest income on securities	$16,614	$17,242

	Six Months Ended June 30,	
	2018	2017
U.S. Treasury	$131	$519
U.S. Government Agency Debentures	89	—
State and Political Subdivisions	12,734	12,711
Other Stocks and Bonds	58	69
Other Equity Securities (1)	—	56
Mortgage-backed Securities	21,104	20,863
Total interest income on securities	$34,116	$34,218

(1) See "Note 1 – Summary of Significant Accounting and Reporting Policies" for further information.

Of the $1.2 million in net securities loss from the AFS portfolio for the six months ended June 30, 2018, there were $1.5 million in realized gains and $2.7 million in realized losses. Of the $247,000 in net securities gains from the AFS portfolio for the six months ended June 30, 2017, there were $3.6 million in realized gains and $3.3 million in realized losses. There were no sales from the HTM portfolio during the six months ended June 30, 2018 or 2017. We calculate realized gains and losses on sales of securities under the specific identification method.

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The amortized cost and estimated fair value of AFS and HTM securities at June 30, 2018, are presented below by contractual maturity (in thousands). Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. MBS are presented in total by category due to the fact that MBS typically are issued with stated principal amounts, and the securities are backed by pools of mortgages that have loans with varying maturities. The characteristics of the underlying pool of mortgages, such as fixed-rate or adjustable-rate, as well as prepayment risk, are passed on to the security holder. The term of a mortgage-backed pass-through security thus approximates the term of the underlying mortgages and can vary significantly due to prepayments.

	June 30, 2018	
	Amortized Cost	Fair Value
AVAILABLE FOR SALE		
Investment Securities:		
Due in one year or less	$34,236	$34,098
Due after one year through five years	95,962	97,415
Due after five years through ten years	167,654	166,242
Due after ten years	511,972	501,285
	809,824	799,040
Mortgage-backed Securities	1,266,215	1,238,954
Total	$2,076,039	$2,037,994

	June 30, 2018	
	Amortized Cost	Fair Value
HELD TO MATURITY		
Investment Securities:		
Due in one year or less	$110	$110
Due after one year through five years	1,122	1,112
Due after five years through ten years	1,970	1,940
Due after ten years	—	—
	3,202	3,162
Mortgage-backed Securities:	161,074	155,893
Total	$164,276	$159,055

Investment securities and MBS with carrying values of $1.23 billion and $1.24 billion were pledged as of June 30, 2018 and December 31, 2017, respectively. Pledged securities may be used to collateralize one or more of the following: Federal Home Loan Bank of Dallas (“FHLB”) borrowings, repurchase agreements, and public funds or for other purposes as required by law.

Equity Investments

Equity investments on our consolidated balance sheet include Community Reinvestment Act funds with a readily determinable fair value as well as equity investments without readily determinable fair values. At June 30, 2018, we had equity investments recorded in our consolidated balance sheet of $12.0 million. At December 31, 2017, we had $5.8 million in equity investments without readily determinable fair values recorded at cost, which approximated their fair value.

Beginning January 1, 2018, upon adoption of ASU 2016-01, equity investments with readily determinable fair values are stated at fair value with realized and unrealized gains and losses reported in income. For periods prior to January 1, 2018, these equity investments were classified as AFS and stated at fair value with unrealized gains and losses reported as a separate component of AOCI, net of tax. Equity investments without readily determinable fair values are recorded at cost less any impairment, if any.

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At December 31, 2017, we had $5.9 million in equity investments included in AFS securities and recorded at fair value, with net unrealized losses of $85,000, net of tax, recognized in AOCI. On January 1, 2018, these unrealized losses were reclassified out of AOCI and into retained earnings with subsequent changes in fair value being recognized in net income. The following is a summary of unrealized and realized gains and losses recognized in net income on equity investments during the three and six months ended June 30, 2018 (in thousands):

	Three Months Ended June 30, 2018	Six Months Ended June 30, 2018
Net (losses) recognized during the period on equity investments	$ (42)	$ (134)
Less: Net gains and (losses) recognized during the period on equity investments sold during the period	—	—
Unrealized (losses) recognized during the reporting period on equity investments still held at the reporting date	$ (42)	$ (134)

Equity investments are assessed quarterly for other-than-temporary impairment. Based upon that evaluation, management does not consider any of our equity investments to be other-than-temporarily impaired at June 30, 2018.

Federal Home Loan Bank Stock

Our FHLB stock, which has limited marketability, is carried at cost.

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6. Loans and Allowance for Probable Loan Losses

Loans in the accompanying consolidated balance sheets are classified as follows (in thousands):

	June 30, 2018	December 31, 2017
Real Estate Loans:		
Construction	$487,286	$ 475,867
1-4 Family Residential	791,359	805,341
Commercial	1,245,936	1,265,159
Commercial Loans	282,723	266,422
Municipal Loans	345,595	345,798
Loans to Individuals	117,984	135,769
Total Loans	3,270,883	3,294,356
Less: Allowance for Loan Losses [(1)]	25,072	20,781
Net Loans	$3,245,811	$ 3,273,575

(1) Loans acquired with the Diboll acquisition were measured at fair value on November 30, 2017 with no carryover of allowance for loan loss. The allowance for loan loss recorded on purchase credit impaired ("PCI") loans totaled $358,000 as of June 30, 2018. There was no allowance for loan loss recorded on PCI loans as of December 31, 2017.

Real Estate Construction Loans

Our construction loans are collateralized by property located primarily in or near the market areas we serve. A number of our construction loans will be owner occupied upon completion. Construction loans for non-owner occupied projects are financed, but these typically have cash flows from leases with tenants, secondary sources of repayment, and in some cases, additional collateral. Our construction loans have both adjustable and fixed interest rates during the construction period. Construction loans to individuals are typically priced and made with the intention of granting the permanent loan on the property. Speculative and commercial construction loans are subject to underwriting standards similar to that of the commercial portfolio. Owner occupied 1-4 family residential construction loans are subject to the underwriting standards of the permanent loan.

Real Estate 1-4 Family Residential Loans

Residential loan originations are generated by our loan officers, in-house origination staff, marketing efforts, present customers, walk-in customers and referrals from real estate agents and builders. We focus our lending efforts primarily on the origination of loans secured by first mortgages on owner occupied 1-4 family residences. Substantially all of our 1-4 family residential originations are secured by properties located in or near our market areas.

Our 1-4 family residential loans generally have maturities ranging from five to 30 years. These loans are typically fully amortizing with monthly payments sufficient to repay the total amount of the loan. Our 1-4 family residential loans are made at both fixed and adjustable interest rates.

Underwriting for 1-4 family residential loans includes debt-to-income analysis, credit history analysis, appraised value and down payment considerations. Changes in the market value of real estate can affect the potential losses in the portfolio.

Commercial Real Estate Loans

Commercial real estate loans as of June 30, 2018 consisted of $1.13 billion of owner and non-owner occupied real estate, $96.4 million of loans secured by multi-family properties and $19.6 million of loans secured by farmland. Commercial real estate loans primarily include loans collateralized by retail, commercial office buildings, multi-family residential buildings, medical facilities and offices, senior living, assisted living and skilled nursing facilities, warehouse facilities, hotels and churches. Management does not consider there to be a risk in any one industry type. In determining whether to originate commercial real estate loans, we generally consider such factors as the financial condition of the borrower and the debt service coverage of the property. Commercial real estate loans are made at both fixed and adjustable interest rates for terms generally up to 20 years.

Commercial Loans

Our commercial loans are diversified loan types including short-term working capital loans for inventory and accounts receivable and short- and medium-term loans for equipment or other business capital expansion. Management does not consider there to be a concentration of risk in any one industry type. In our commercial loan underwriting, we assess the creditworthiness, ability to repay, and the value and liquidity of the collateral being offered. Terms of commercial loans are generally commensurate with the useful life of the collateral offered.

Municipal Loans

We have a specific lending department that makes loans to municipalities and school districts primarily throughout the state of Texas. Municipal loans outside the state of Texas have been limited to adjoining states. The majority of the loans to municipalities and school districts have tax or revenue pledges and in some cases are additionally supported by collateral. Municipal loans made without a direct pledge of taxes or revenues are usually made based on some type of collateral that represents an essential service.

Loans to Individuals

Substantially all originations of our loans to individuals are made to consumers in our market areas. The majority of loans to individuals are collateralized by titled equipment, which are primarily automobiles. Loan terms vary according to the type and value of collateral, length of contract and creditworthiness of the borrower. The underwriting standards we employ for consumer loans include an application, a determination of the applicant’s payment history on other debts, with the greatest weight being given to payment history with us, and an assessment of the borrower’s ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, in relation to the proposed loan amount. Most of our loans to individuals are collateralized, which management believes assists in limiting our exposure.

Allowance for Loan Losses

The allowance for loan losses is based on the most current review of the loan portfolio and is a result of multiple processes. First, we utilize historical net charge-off data to establish general reserve amounts for each class of loans. The historical charge-off figure is further adjusted through qualitative factors that include general trends in past dues, nonaccruals and classified loans to more effectively and promptly react to both positive and negative movements not reflected in the historical data. Second, our lenders have the primary responsibility for identifying problem loans based on customer financial stress and underlying collateral. These recommendations are reviewed by senior loan administration, the special assets department, and the loan review department on a monthly basis. Third, the loan review department independently reviews the portfolio on an annual basis. The loan review department follows a board-approved annual loan review scope. The loan review scope encompasses a number of considerations including the size of the loan, the type of credit extended, the seasoning of the loan and the performance of the loan. The loan review scope, as it relates to size, focuses more on larger dollar loan relationships, typically aggregate debt of $500,000 or greater. The loan review officer also reviews specific reserves compared to general reserves to determine trends in comparative reserves as well as losses not reserved for prior to charge-off to determine the effectiveness of the specific reserve process.

At each review, a subjective analysis methodology is used to grade the respective loan. Categories of grading vary in severity from loans that do not appear to have a significant probability of loss at the time of review to loans that indicate a probability that the entire balance of the loan will be uncollectible. If at the time of review we determine it is probable that we will not collect the principal and interest cash flows contractually due on the loan, estimates of future expected cash flows or appraisals of the collateral securing the debt are used to determine the necessary allowances. The internal loan review department maintains a list (“Watch List”) of all loans or loan relationships that are graded as having more than the normal degree of risk associated with them. In addition, a list of specifically reserved loans or loan relationships of $150,000 or more is updated on a quarterly basis in order to properly determine necessary allowances and keep management informed on the status of attempts to correct the deficiencies noted with respect to the loan.

We calculate historical loss ratios for pools of loans with similar characteristics based on the proportion of actual charge-offs experienced, consistent with the characteristics of remaining loans, to the total population of loans in the pool. The historical gross loss ratios are updated quarterly based on actual charge-off experience and adjusted for qualitative factors. All loans are subject to individual analysis if determined to be impaired with the exception of consumer loans and loans secured by 1-4 family residential loans.

Industry and our own experience indicates that a portion of our loans will become delinquent and a portion of our loans will require partial or full charge-off. Regardless of the underwriting criteria utilized, losses may occur as a result of various factors beyond our control, including, among other things, changes in market conditions affecting the value of properties used as collateral for loans and problems affecting the credit worthiness of the borrower and the ability of the borrower to make payments on the loan. Our determination of the appropriateness of the allowance for loan losses is based on various considerations, including an analysis of the risk characteristics of various classifications of loans, previous loan loss experience, specific loans which have loan loss potential, delinquency trends, estimated fair value of the underlying collateral, current economic conditions, and geographic and industry loan concentration.

Credit Quality Indicators

We categorize loans into risk categories on an ongoing basis based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. We use the following definitions for risk ratings:

- Pass (Rating 1 – 4) – This rating is assigned to all satisfactory loans. This category, by definition, consists of acceptable credit. Credit and collateral exceptions should not be present, although their presence would not necessarily prohibit a loan from being rated Pass, if deficiencies are in the process of correction. These loans are not included in the Watch List.
- Pass Watch (Rating 5) – These loans require some degree of special treatment, but not due to credit quality. This category does not include loans specially mentioned or adversely classified; however, particular attention is warranted to characteristics such as:
  A lack of, or abnormally extended payment program;
  A heavy degree of concentration of collateral without sufficient margin;
  A vulnerability to competition through lesser or extensive financial leverage; and
  A dependence on a single or few customers or sources of supply and materials without suitable substitutes or alternatives.
- Special Mention (Rating 6) – A Special Mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in our credit position at some future date. Special Mention loans are not adversely classified and do not expose us to sufficient risk to warrant adverse classification.
- Substandard (Rating 7) – Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.
- Doubtful (Rating 8) – Loans classified as Doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation, in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

All accruing loans are reserved for as a group of similar type credits and included in the general portion of the allowance for loan losses. Loans to individuals and 1-4 family residential loans, including loans not accruing, are collectively evaluated and included in the general portion of the allowance for loan losses. All loans considered troubled debt restructurings ("TDR") are evaluated individually for impairment.

The general portion of the loan loss allowance is reflective of historical charge-off levels for similar loans adjusted for changes in current conditions and other relevant factors. These factors are likely to cause estimated losses to differ from historical loss experience and include:

- Changes in lending policies or procedures, including underwriting, collection, charge-off, and recovery procedures;
- Changes in local, regional and national economic and business conditions, including entry into new markets;
- Changes in the volume or type of credit extended;
- Changes in the experience, ability, and depth of lending management;
- Changes in the volume and severity of past due, nonaccrual, restructured, or classified loans;
- Changes in charge-off trends;
- Changes in loan review or Board oversight;
- Changes in the level of concentrations of credit; and

• Changes in external factors, such as competition and legal and regulatory requirements.

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These factors are also considered for the non-PCI loan portfolio specifically in regards to changes in credit quality, past due, nonaccrual and charge-off trends.

The following tables detail activity in the allowance for loan losses by portfolio segment for the periods presented (in thousands):

	Three Months Ended June 30, 2018						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Balance at beginning of period	$3,597	$ 2,377	$ 14,089	$ 2,385	$ 851	$ 921	$24,220
Provision (reversal) for loan losses [2]	244	403	(57)	328	8	355	1,281
Loans charged off	—	(57)	—	(172)	—	(688)	(917)
Recoveries of loans charged off	—	7	4	19	—	458	488
Balance at end of period	$3,841	$ 2,730	$ 14,036	$ 2,560	$ 859	$ 1,046	$25,072

	Six Months Ended June 30, 2018						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Balance at beginning of period [1]	$3,676	$ 2,445	$ 10,821	$ 2,094	$ 860	$ 885	$20,781
Provision (reversal) for loan losses [2]	179	321	3,209	661	(1)	647	5,016
Loans charged off	(14)	(57)	—	(257)	—	(1,356)	(1,684)
Recoveries of loans charged off	—	21	6	62	—	870	959
Balance at end of period	$3,841	$ 2,730	$ 14,036	$ 2,560	$ 859	$ 1,046	$25,072

	Three Months Ended June 30, 2017						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Balance at beginning of period	$3,407	$ 2,317	$ 8,787	$ 2,259	$ 746	$ 969	$18,485
Provision (reversal) for loan losses [2]	182	74	1,180	(161)	19	52	1,346
Loans charged off	(17)	(1)	—	(574)	—	(496)	(1,088)
Recoveries of loans charged off	1	2	3	100	—	392	498
Balance at end of period	$3,573	$ 2,392	$ 9,970	$ 1,624	$ 765	$ 917	$19,241

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	Six Months Ended June 30, 2017						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Balance at beginning of period	$4,147	$ 2,665	$ 7,204	$ 2,263	$ 750	$ 882	$17,911
Provision (reversal) for loan losses [2]	(540)	12	2,757	(273)	15	473	2,444
Loans charged off	(35)	(288)	—	(577)	—	(1,242)	(2,142)
Recoveries of loans charged off	1	3	9	211	—	804	1,028
Balance at end of period	$3,573	$ 2,392	$ 9,970	$ 1,624	$ 765	$ 917	$19,241

(1) Loans acquired with the Diboll acquisition were measured at fair value on November 30, 2017 with no carryover of allowance for loan loss.

(2) Of the $1.3 million and $5.0 million recorded in provision for loan losses for the three and six months ended June 30, 2018, $358,000 related to provision expense on PCI loans. Of the $1.3 million and $2.4 million recorded in provision for loan losses for the three and six months ended June 30, 2017, none related to provision expense on PCI loans.

The following tables present the balance in the allowance for loan losses by portfolio segment based on impairment method (in thousands):

	As of June 30, 2018						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Ending balance – individually evaluated for impairment [1]	$14	$ 40	$ 4,445	$ 330	$ 10	$ 86	$4,925
Ending balance – collectively evaluated for impairment	3,827	2,690	9,591	2,230	849	960	20,147
Balance at end of period	$3,841	$ 2,730	$ 14,036	$ 2,560	$ 859	$ 1,046	$25,072

	As of December 31, 2017						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Ending balance – individually evaluated for impairment [1]	$12	$ 14	$ 14	$ 252	$ 10	$ 51	$353
Ending balance – collectively evaluated for impairment	3,664	2,431	10,807	1,842	850	834	20,428
Balance at end of period	$3,676	$ 2,445	$ 10,821	$ 2,094	$ 860	$ 885	$20,781

(1) The allowance for loan loss on PCI loans totaled $358,000 as of June 30, 2018. There was no allowance for loan losses associated with PCI loans as of December 31, 2017.

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The following tables present the recorded investment in loans by portfolio segment based on impairment method (in thousands):

	June 30, 2018						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Loans individually evaluated for impairment	$118	$1,612	$30,967	$1,419	$502	$260	$34,878
Loans collectively evaluated for impairment	486,262	778,153	1,193,051	278,290	345,093	116,957	3,197,806
Purchased credit impaired loans	906	11,594	21,918	3,014	—	767	38,199
Total ending loan balance	$487,286	$791,359	$1,245,936	$282,723	$345,595	$117,984	$3,270,883

	December 31, 2017						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Loans individually evaluated for impairment	$86	$1,581	$895	$1,429	$502	$205	$4,698
Loans collectively evaluated for impairment	475,505	797,111	1,232,327	259,745	345,296	134,441	3,244,425
Purchased credit impaired loans	276	6,649	31,937	5,248	—	1,123	45,233
Total ending loan balance	$475,867	$805,341	$1,265,159	$266,422	$345,798	$135,769	$3,294,356

The following tables set forth credit quality indicators by class of loans for the periods presented (in thousands):

	June 30, 2018					
	Pass	Pass Watch (1)	Special Mention (1)	Substandard (1)	Doubtful (1)	Total
Real Estate Loans:						
Construction	$479,518	$765	$6,088	$ 861	$54	$487,286
1-4 Family Residential	781,663	639	868	6,616	1,573	791,359
Commercial	1,111,236	20,946	64,563	48,361	830	1,245,936
Commercial Loans	274,827	1,323	3,712	2,633	228	282,723
Municipal Loans	344,234	—	859	502	—	345,595
Loans to Individuals	116,922	42	48	704	268	117,984
Total	$3,108,400	$23,715	$76,138	$ 59,677	$2,953	$3,270,883

	December 31, 2017					
	Pass	Pass Watch (1)	Special Mention (1)	Substandard (1)	Doubtful (1)	Total
Real Estate Loans:						
Construction	$471,446	$3,329	$77	$ 982	$33	$475,867
1-4 Family Residential	796,639	559	857	6,610	676	805,341
Commercial	1,136,576	26,275	25,301	76,625	382	1,265,159
Commercial Loans	247,430	9,625	3,956	5,203	208	266,422
Municipal Loans	344,366	—	930	502	—	345,798
Loans to Individuals	134,694	20	102	707	246	135,769
Total	$3,131,151	$39,808	$31,223	$ 90,629	$1,545	$3,294,356

(1) Includes PCI loans comprised of $161,000 pass watch, $4.1 million special mention, $8.2 million substandard and $1.1 doubtful as of June 30, 2018. Includes PCI loans comprised of $362,000 pass watch, $6.0 million special mention, $10.5 million substandard and $925,000 doubtful as of December 31, 2017.

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Nonperforming Assets and Past Due Loans

Nonaccrual loans are loans 90 days or more delinquent and collection in full of both the principal and interest is not expected. Additionally, some loans that are not delinquent or that are delinquent less than 90 days may be placed on nonaccrual status if it is probable that we will not receive contractual principal and interest payments in accordance with the terms of the respective loan agreement. When a loan is categorized as nonaccrual, the accrual of interest is discontinued and any accrued balance is reversed for financial statement purposes. Payments received on nonaccrual loans are applied to the outstanding principal balance. Payments of contractual interest are recognized as income only to the extent that full recovery of the principal balance of the loan is reasonably certain. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Other factors, such as the value of collateral securing the loan and the financial condition of the borrower, are considered in judgments as to potential loan loss.

Nonaccrual loans and accruing loans past due more than 90 days include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

PCI loans are recorded at fair value at acquisition date. Although the PCI loans may be contractually delinquent, we do not classify these loans as past due or nonperforming when the timing and amount of expected cash flows can be reasonably estimated, as the loans were written down to fair value at the acquisition date and the accretable yield is recognized in interest income over the remaining life of the loan. However, subsequent to acquisition, we re-assess PCI loans for additional impairment and record additional impairment in the event we conclude it is probable that we will be unable to collect all cash flows originally expected to be collected at acquisition plus any additional cash flows expected to be collected due to changes in estimates after acquisition. All such PCI loans for which we recognize subsequent impairment are reported as impaired loans in the financial statements.

The following table sets forth nonperforming assets for the periods presented (in thousands):

	At June 30, 2018	At December 31, 2017
Nonaccrual loans (1)	$35,351	$ 2,937
Accruing loans past due more than 90 days (1)	7	1
Restructured loans (2)	5,860	5,767
Other real estate owned	1,137	1,613
Repossessed assets	68	154
Total Nonperforming Assets	$42,423	$ 10,472

(1) Excludes PCI loans measured at fair value at acquisition if the timing and amount of cash flows expected to be collected from those sales can be reasonably estimated. The increase in nonaccrual loans was primarily the result of the addition of two large commercial real estate relationships consisting of three loans in the first quarter of 2018.
(2) Includes $2.9 million in PCI loans restructured as of June 30, 2018 and December 31, 2017.

Foreclosed assets include other real estate owned and repossessed assets. For 1-4 family residential real estate properties, a loan is recognized as a foreclosed property once legal title to the real estate property has been received upon completion of foreclosure or the borrower has conveyed all interest in the residential property through a deed in lieu of foreclosure. There were $344,000 and $154,000 in loans secured by 1-4 family residential properties for which formal foreclosure proceedings were in process as of June 30, 2018 and December 31, 2017, respectively.

The following table sets forth the recorded investment in nonaccrual loans by class of loans for the periods presented (in thousands). The table excludes PCI loans measured at fair value at acquisition:

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	Nonaccrual Loans	
	June 30, 2018	December 31, 2017
Real Estate Loans:		
Construction	$119	$ 86
1-4 Family Residential	1,795	1,098
Commercial	32,146	595
Commercial Loans	951	903
Loans to Individuals	340	255
Total	$35,351	$ 2,937

Loans are considered impaired if, based on current information and events, it is probable we will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for larger loans. The measurement of loss on impaired loans is generally based on the fair value of the collateral less selling costs if repayment is expected solely from the collateral or the present value of the expected future cash flows discounted at the historical effective interest rate stipulated in the loan agreement. In measuring the fair value of the collateral, in addition to relying on third party appraisals, we use assumptions, such as discount rates, and methodologies, such as comparison to the recent selling price of similar assets, consistent with those that would be utilized by unrelated third parties performing a valuation. Loans that are evaluated and determined not to meet the definition of an impaired loan are reserved for at the general reserve rate for its appropriate class.

At the time a loss is probable in the collection of contractual amounts, specific reserves are allocated. Loans are charged off to the liquidation value of the collateral net of liquidation costs, if any, when deemed uncollectible or as soon as collection by liquidation is evident.

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The following tables set forth impaired loans by class of loans for the periods presented (in thousands). Impaired loans include restructured and nonaccrual loans for which the allowance was measured in accordance with section 310-10 of ASC Topic 310, "Receivables." There were no impaired loans recorded without an allowance as of June 30, 2018 or December 31, 2017.

	June 30, 2018		
	Unpaid Contractual Principal Balance	Recorded Investment	Related Allowance for Loan Losses
Real Estate Loans:			
Construction	$347	$ 308	$ 14
1-4 Family Residential	4,219	4,007	40
Commercial	33,624	32,999	4,445
Commercial Loans	3,257	2,742	330
Municipal Loans	502	502	10
Loans to Individuals	319	288	86
Total (1)	$42,268	$ 40,846	$ 4,925

	December 31, 2017		
	Unpaid Contractual Principal Balance	Recorded Investment	Related Allowance for Loan Losses
Real Estate Loans:			
Construction	$91	$ 86	$ 12
1-4 Family Residential	4,141	3,952	14
Commercial	1,353	1,199	14
Commercial Loans	1,665	1,605	252
Municipal Loans	502	502	10
Loans to Individuals	237	205	51
Total (1)	$7,989	$ 7,549	$ 353

(1) Includes $6.0 million and $2.9 million of PCI loans that experienced deterioration in credit quality subsequent to the acquisition date as of June 30, 2018 and December 31, 2017, respectively.

The following tables present the aging of the recorded investment in past due loans by class of loans (in thousands):

June 30,
2018