

# 2017

ANNUAL REPORT



FRANKLIN  
**FINANCIAL**  
NETWORK, INC.



**About Franklin Financial Network, Inc.:**

Franklin Financial Network, Inc. is a financial holding company headquartered in Franklin, Tennessee. The Company's wholly owned bank subsidiary, Franklin Synergy Bank, a Tennessee-chartered commercial bank founded in November 2007 and a member of the Federal Reserve System, provides a full range of banking and related financial services with a focus on service to small businesses, corporate entities, local governments and individuals. With consolidated total assets of \$3.8 billion at December 31, 2017, the Bank currently operates through 14 branches and one loan production office in the growing Williamson, Rutherford and Davidson Counties, all within the Nashville metropolitan statistical area. Additional information about the Company, which is included in the NYSE Financial-100 Index, and the FTSE Russell 2000 Index, is available at [www.FranklinSynergyBank.com](http://www.FranklinSynergyBank.com).



## Dear Fellow Shareholder:

Franklin Financial Network announced another year of record growth and earnings; however, 2017 was not without its challenges. Simply put, we are not satisfied with our 2017 share price performance, which registered a decline of 19% for the year. Understanding that some market forces are beyond our control, we are fully focused on continuing our mission to enhance shareholder value and believe that a strong foundation is in place to successfully execute our business plan. Franklin Financial Network is a franchise defined by rapid growth, disciplined credit and deep real estate expertise. We operate in one of the most attractive geographic markets in the country, and we remain excited about our prospects for 2018 and beyond.

Our entire team contributed to the many positive accomplishments in 2017. Our growth trajectory notably continues to outpace our peers and the broader industry, and included loan growth of 27% and deposit growth of 32%. The bank maintained stellar credit quality, and, during 2017, we continued to refine our ability to be disciplined, conservative underwriters of each new loan. We focus on the less risky sectors of the real estate

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**Franklin Financial Network is a franchise defined by rapid growth, disciplined credit and deep real estate expertise. We operate in one of the most attractive geographic markets in the country, and we remain excited about our prospects for 2018 and beyond.**

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market, originate high quality loans and actively manage each relationship. Those factors led to improved credit metrics in 2017 compared to 2016, even as we substantially grew our balance sheet. Net recoveries of 0.02% were realized for the year, our ratio of nonperforming loans to total loans improved 22 basis points to 0.13% and our allowance for loan losses increased slightly to 0.94% of total loans. In short, the soundness of our franchise remains strong.

Also in 2017, we continued significant investments to support our ongoing growth. We opened a new flagship branch in Murfreesboro, which is in Rutherford County, and we expect the new location to help drive growth in customer deposits. Our acquisition of Civic Bank & Trust was approved by regulators, resulting in closing the transaction on April 1, 2018. Civic's premier location represents our first physical expansion into Davidson County, providing an established platform for our expansion in the dynamic Nashville market. Our

new branch and the Civic acquisition help us build scale and increase market share in one of the best metropolitan areas in the country. The bank also made significant investments in technology and infrastructure during the year that will support the franchise as it continues to grow organically and through opportunistic acquisitions.

Despite these meaningful accomplishments, a key measure of profitability, net interest margin, was impacted by both rising interest rates and a flattening yield curve, declining 36 basis points to 3.06% compared to 2016. Over the same period, net interest income grew an impressive 19%, contributing to record net income. We are executing our plan to continue the growth in net interest income while addressing the margin challenges. Our leadership team has extensive experience leading banks through interest rate and economic cycles, and we are confident of both our strategy and our ability to successfully manage through the current cycle.

In closing, our Company, as measured by soundness, growth and profitability, remains strong. We will continue to execute our differentiated business strategy, and we remain optimistic about our prospects for 2018 and beyond. We recognize our outstanding team at Franklin Financial Network and thank all of our colleagues for their unceasing efforts to provide the best service to our customers. Our Middle Tennessee market has provided a strong growth environment, but without the commitment, discipline and entrepreneurship of our employees, we could not have grown so successfully or created the deep relationships that define our franchise. We remain fundamentally committed to our business model and confident that strong execution will create long-term shareholder value. As your fellow shareholder, thank you for your investment in Franklin Financial Network.

Sincerely,

A handwritten signature in black ink, appearing to read "Richard E. Herrington". The signature is stylized and includes a large, sweeping flourish at the end.

Richard E. Herrington  
*Chairman, President and  
Chief Executive Officer*

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-K**

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

For the fiscal year ended December 31, 2017

**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 001-36895

**FRANKLIN FINANCIAL NETWORK, INC.**

(Exact name of registrant as specified in its charter)

Tennessee  
(State or other jurisdiction of  
incorporation or organization)

20-8839445  
(I.R.S. Employer  
Identification No.)

722 Columbia Avenue, Franklin, Tennessee 37064

(Address of principal executive offices) (Zip Code)

615-236-2265

(Registrant's telephone number, including area code)

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

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

None

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  Yes  No

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 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 Act).  Yes  No

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold as of June 30, 2017 was \$509,234,064.30 (computed on the basis of \$41.85 per share).

The number of shares outstanding of the registrant's common stock, no par value per share, as of February 28, 2018 was 13,252,772.

**DOCUMENTS INCORPORATED BY REFERENCE**

The information required by Part III is incorporated by reference to portions of the definitive proxy statement to be filed within 120 days after December 31, 2017, pursuant to Regulation 14A under the Securities Exchange Act of 1934 in connection with the annual meeting of stockholders to be held on May 24, 2018.

## TABLE OF CONTENTS

<u>PART I</u>		2
ITEM 1.	<u>BUSINESS</u>	2
ITEM 1A.	<u>RISK FACTORS</u>	13
ITEM 1B.	<u>UNRESOLVED STAFF COMMENTS</u>	28
ITEM 2.	<u>PROPERTIES</u>	28
ITEM 3.	<u>LEGAL PROCEEDINGS</u>	28
ITEM 4.	<u>MINE SAFETY DISCLOSURES</u>	28
<u>PART II</u>		29
ITEM 5.	<u>MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES</u>	29
ITEM 6.	<u>SELECTED FINANCIAL DATA</u>	31
ITEM 7.	<u>MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	33
ITEM 7A.	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	59
ITEM 8.	<u>FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u>	60
ITEM 9.	<u>CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE</u>	60
ITEM 9A.	<u>CONTROLS AND PROCEDURES</u>	60
ITEM 9B.	<u>OTHER INFORMATION</u>	61
<u>PART III</u>		62
ITEM 10.	<u>DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE</u>	62
ITEM 11.	<u>EXECUTIVE COMPENSATION</u>	62
ITEM 12.	<u>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS</u>	62
ITEM 13.	<u>CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE</u>	62
ITEM 14.	<u>PRINCIPAL ACCOUNTING FEES AND SERVICES</u>	62
<u>PART IV</u>		63
ITEM 15.	<u>EXHIBITS AND FINANCIAL STATEMENT SCHEDULES</u>	63
ITEM 16.	<u>FORM 10-K SUMMARY</u>	63
<u>EXHIBIT INDEX</u>		63
<u>SIGNATURES</u>		70
<u>INDEX TO FINANCIAL STATEMENTS</u>		F-1

## **CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS**

This Annual Report on Form 10-K contains forward-looking statements regarding, among other things, our anticipated financial and operating results. Forward-looking statements reflect our management’s current assumptions, beliefs, and expectations. Words such as “anticipate,” “believe,” “estimate,” “expect,” “intend,” “plan,” “objective,” “should,” “hope,” “pursue,” “seek,” and similar expressions are intended to identify forward-looking statements. While we believe that the expectations reflected in our forward-looking statements are reasonable, we can give no assurance that such expectations will prove correct. Forward-looking statements are subject to risks and uncertainties that could cause our actual results to differ materially from the future results, performance, or achievements expressed in or implied by any forward-looking statement we make. Some of the relevant risks and uncertainties that could cause our actual performance to differ materially from the forward-looking statements contained in this report are discussed below under the heading “Risk Factors” and elsewhere in this Annual Report on Form 10-K. We caution readers that these discussions of important risks and uncertainties are not exclusive, and our business may be subject to other risks and uncertainties which are not detailed there. Readers are cautioned not to place undue reliance on our forward-looking statements. We make forward-looking statements as of the date on which this Annual Report on Form 10-K is filed with the Securities and Exchange Commission (“SEC”), and we assume no obligation to update the forward-looking statements after the date hereof whether as a result of new information or events, changed circumstances, or otherwise, except as required by law.

## PART I

### ITEM 1. BUSINESS.

#### Company Overview

We are a financial holding company headquartered in Franklin, Tennessee. Through our wholly owned bank subsidiary, Franklin Synergy Bank, a Tennessee-chartered commercial bank and a member of the Federal Reserve System, we provide a full range of banking and related financial services with a focus on service to small businesses, corporate entities, local governments and individuals. We operate through 13 branches and one loan production office in the demographically attractive and growing Williamson, Rutherford and Davidson Counties within the Nashville metropolitan area. As used in this report, unless the context otherwise indicates, any reference to “Franklin Financial,” “our company,” “the company,” “us,” “we” and “our” refers to Franklin Financial Network, Inc. together with its consolidated subsidiaries (including Franklin Synergy Bank), any reference to “FFN” refers to Franklin Financial Network, Inc. only and any reference to “Franklin Synergy” or the “Bank” refers to our banking subsidiary, Franklin Synergy Bank.

As of December 31, 2017, we had consolidated total assets of \$3.8 billion, total loans, including loans held for sale, of \$2.3 billion, total deposits of \$3.2 billion and total equity of \$304.7 million.

Our principal executive office is located at 722 Columbia Avenue, Franklin, Tennessee 37064-2828, and our telephone number is (615) 236-2265. Our website is [www.franklinsynergybank.com](http://www.franklinsynergybank.com). The information contained on or accessible from our website does not constitute a part of this report and is not incorporated by reference herein.

#### Our History and Growth

We were formed as a Tennessee corporation in April 2007 and commenced banking operations through the newly-formed Franklin Synergy Bank in November 2007. We were established with the initial objective of building a locally-managed commercial bank to service the needs of Franklin, Tennessee and the greater Williamson County area. Our mission statement is to build a legacy company by creating shareholder value, cultivating strong customer relationships and fostering an extraordinary team of directors, officers and employees. We were formed by a core management team of veteran bankers based in Middle Tennessee led by our Chairman and Chief Executive Officer, Richard Herrington. Many of our founders built Franklin Financial Corporation (which is not directly affiliated with our company), which was founded in 1988, and grew the newly-formed real estate-oriented bank to nine branches and \$785 million in assets as of June 30, 2002, before announcing the sale of the bank to Fifth Third Bancorp, Inc. in July 2002. Mr. Herrington and certain members of this management team subsequently joined Cumberland Bancorp, Inc. (later renamed Civitas BankGroup, Inc.), a troubled Tennessee-based bank holding company, in December 2002, to lead its restructuring. The team led a dramatic improvement of Cumberland’s asset quality and profitability, by decreasing nonperforming loans to total loans from 2.25% in 2003 to 0.31% in 2006 and growing net income from \$1.1 million in 2003 to \$6.7 million in 2006, before it was acquired by Greene County Bancshares, Inc. in May 2007.

On July 1, 2014, we completed our acquisition of MidSouth Bank (“MidSouth”) which enabled us to increase our footprint in Middle Tennessee and in the Nashville metropolitan area, specifically in the attractive Rutherford County market. The acquisition also diversified our revenue mix by expanding our retail customer base and increasing our capacity to provide wealth management services, including trust powers which we believe is a competitive advantage to drive new relationships with higher income customers.

FFN and the Bank entered into an Agreement and Plan of Reorganization and Bank Merger with Civic Bank & Trust (“Civic”), a Tennessee banking corporation, on December 14, 2015, as amended by Amendment No. 1 thereto, dated May 9, 2016, Amendment No. 2 thereto, dated March 30, 2017, and Amendment No. 3 thereto, dated September 29, 2017, pursuant to which Civic will merge with and into the Bank, with the Bank as the surviving Tennessee banking corporation. We received the approval of the TDFI on April 13, 2016 and approval from the Federal Reserve Board (FRB) on December 28, 2017. The proposed merger has been approved by each company’s Board of Directors, and is subject to approval by Civic’s shareholders. Civic has called a special meeting of shareholders to be held on March 30, 2018 at 10:00 a.m. Central Time for approval of the merger.

#### Our Market

We operate 13 branches in Williamson and Rutherford Counties and one loan production office within the Nashville metropolitan area. Our markets are among the most attractive, both in Tennessee, and the Southeast, and compare favorably to some of the more well-known and higher-profile markets in the U.S., although our markets are not dependent on commodity pricing. We believe that our focus on, and success in, growing market share in Williamson and Rutherford Counties will enhance our long-term value and profitability compared to financial institutions of our size in other regions of the country. The markets in which we operate are characterized by strong demographics including high incomes, increasing population, a growing workforce and unemployment that tends to be below the national rate.



## **Our Business Strategy**

We consider ourselves to be bankers, not just lenders. Our core business strategy is to provide our banking customers with a full suite of financial services by cultivating strong long-term customer relationships and by developing an extraordinary team of officers and employees focused on the customer experience. We are focused on providing convenience and personal service to our customers that is superior to that of the out-of-state super-regional and national financial institutions operating in our markets, while simultaneously managing risk and profitability by remaining selective when expanding our customer base and making loans. We also prioritize our client's financial security and privacy and assist the communities in which we do business through socially responsible leadership. Our unique culture is a cornerstone to our business and has resulted in substantial but stable growth and profitability.

By continuing to offer several value-added products and services within our core areas of strength, such as mortgage lending and wealth management, to invest in technology to improve our systems and the customer experience, and to leverage strong relationships with consumers, professionals, local governments and businesses within our community, we believe we can gain greater market share, which will improve our operational efficiency and increase profitability. As evidence of the success of our strategy, our deposit market share in Williamson County has increased from 3.4% in 2009 to a market-leading deposit share of approximately 25.3% per the Federal Deposit Insurance Corporation's ("FDIC's") Summary of Deposits report as of June 30, 2017, despite the presence of more institutions competing for deposits. The Company's deposit market share in Rutherford County has grown to 12.2%, which is the second-most deposit share in the Rutherford County market.

## **Our Competitive Strengths**

We believe that we have a unique operating culture that differentiates us from our competitors and enables us to organically grow our business and enhance shareholder value. This unique operating culture includes:

- a commitment to provide superior and personal service to our customers, both through our employees and via our continued investment in cutting edge technologies in areas of deposit taking, loan origination and risk management;
- a focus on building long-term relationships with our customers; and
- community leadership, as we look to engage with local civic, professional and charitable organizations and exhort our employees to do so as well.

Our culture forms the basis for our competitive strengths, which we believe allow us to leverage our market opportunity and grow our business profitability. In particular, we believe that the following strengths differentiate us from our competitors and provide a strong foundation from which to deliver growth and profitability, all while enhancing shareholder value:

### ***Well Positioned in Attractive Markets***

We believe that we are well positioned to grow our business profitably in the demographically attractive and growing markets within the Nashville metropolitan area in which we operate. We believe that our target market segments, small to medium size for profit businesses and the consumer base working or living in and near our geographical footprint, demand the convenience and personal service that a smaller, independent financial institution such as we can offer. We believe the heavy out-of-state banking presence (out-of-state super-regional and national financial institutions control approximately 53.6% of local deposits in the Nashville-Davidson-Murfreesboro-Franklin metropolitan statistical area (the "Nashville MSA") as of June 30, 2017) provides an opportunity for a strong local bank like us to add greater market share from customers who are looking for more personal banking services and a more customer-friendly experience. Through our efforts to expand our deposit base, we currently have the largest market share of deposits in Williamson County.

### ***Experienced Management Team***

We have an experienced management team with a history of working together in our target markets and a track record of delivering growth and shareholder value. Many members of our executive leadership team have been with us since inception and many have worked together at previous banks, including both large financial institutions and community banks. Our Chief Executive Officer, President, Chief Mortgage Officer, Chief Financial Officer, Chief Investment Officer and Chief Credit Officer have worked in our local market for a number of years and have experienced a variety of economic cycles. This deep local experience has given us the ability to understand and react to market changes and maintain strong profitability and growth without sacrificing asset quality.

Our management team has a proven track record of delivering shareholder value. Richard Herrington co-founded Franklin Financial Corporation (Franklin National Bank) in 1988, where he and his management team grew assets by a compound annual growth rate ("CAGR") of 27.5% from 1995 – 2002 and positioned the bank to eventually be sold to Fifth Third Bancorp, Inc., which was announced in 2002 and closed in 2004, for 5.4 times tangible book value. According to SNL Financial, this multiple represents

the 9th highest price to book multiple for all bank transactions announced in the past 20 years where deal value was in excess of \$50 million. He then served as Chief Executive Officer at Cumberland Bancorp, Inc. (later renamed Civitas BankGroup, Inc.), where he and his team restructured the bank and significantly bolstered profitability, growing net income by a CAGR of 82% from 2003 – 2006, before selling the bank to Greene County Bancshares, Inc. in 2007 for 3.0 times tangible book value.

The members of our Board of Directors have diverse industry experiences and have deep and long-term ties to the local community. We believe that we have an ideal blend of directors that have been with our management team at previous banks as well as directors that have joined our Board in recent years.

### ***Local Real Estate Lending Expertise***

We are real estate bankers that have focused on Middle Tennessee collateral since 1989. Our in-depth knowledge of the commercial customers, real estate development and credit in Williamson and Rutherford Counties gives us a competitive advantage in loan production, deposit attraction and ancillary revenue generation as we grow market share. Even when the local loan market gets competitive, we do not compromise on pricing and structuring of loan facilities, as our bankers are able to provide customized solutions delivered with a relatively quick turnaround time, as a result of the fact that our underwriting and banking operations occur locally.

With our firm principles of lending on Middle Tennessee collateral, our local real estate expertise and our localized delivery apparatus, we are poised to capture greater market share in the demographically-attractive and growing Williamson and Rutherford Counties.

### ***Successful Balance of Growth and Profitability***

We understand the importance of successfully balancing growth and profitability with asset quality to enhance shareholder value. The following highlights the key aspects of our approach to maintaining this balance:

- *Consistent, Strong and Disciplined Growth.* Our approach balances both disciplined growth and profitability. Our community-focused business model has resulted in loan growth with a CAGR of 39% from December 31, 2009 to December 31, 2017. Since opening in 2007, we have expanded into the very attractive Rutherford County market, and we have added a loan production office in Davidson County. Additionally, we have increased focus on small business lending and have grown our commercial and industrial (“C&I”) loans, which represent approximately 22.3% of our portfolio at December 31, 2017, by a CAGR of nearly 64% since 2009. We have grown our deposit market share in Williamson County and are the top local financial institution in the county by deposits with a market share of approximately 25%. Our growth has resulted in improved profitability, as reflected by return on average assets increasing from negative in 2009 to 0.82% for 2017.
- *Disciplined Credit Risk Management.* Our robust approach to risk management has enabled growth of our loan portfolio without compromising credit. Our credit risk management strategy is based on prudent underwriting criteria and local knowledge. Our lending decisions are centralized and committee-focused, with committees meeting multiple times per week. We are collateral lenders, with strong focus on secondary sources of repayment, especially collateral based in Williamson and Rutherford Counties. As a result of the implementation of our risk management strategy, less than 2% of our total loans are unsecured.

We believe that by maintaining our consistent origination and underwriting strategy, we will be able to maintain our consistent growth across shifting market environments.

### **Products and Services**

The Bank operates as a full-service financial institution for its customers in its expanded market area with a full line of financial products, including:

#### ***Commercial Banking***

Traditional commercial banking services are the mainstay of the Bank. The Bank’s focus is to service small to medium-sized businesses and self-employed professionals. Certain not-for-profit and governmental entities also find the Bank’s services attractive.

The Bank’s focus in the commercial banking market is to provide high quality service for its customers supported by the latest bank technology. In the credit service area, the Bank endeavors to give its commercial customers access to a highly-trained team of credit and deposit service specialists who remain with the customer relationship for long periods of time. Credit decision-making is customized to meet the borrower’s financial needs and designed for rapid response. Credit judgments involve the Bank’s senior management and, where legally required, involve the directors of the Bank. Government guaranteed lending services such as the Small Business Administration (“SBA”) may be utilized as needed.

### ***Consumer Banking***

The Bank offers a broad range of financial services designed to meet the credit, savings, and transactional needs of local consumers. First mortgage real estate loans, home equity loans, and other personal loans are the focus of consumer lending. Consumer depository and transaction needs are met through dual delivery systems of traditional branches and the Internet, including mobile banking.

### ***Mortgage Loans***

Our mortgage loan department originates single-family, fixed rate residential mortgage loans that we sell in the secondary market. Construction loans also are available for residential and commercial purposes.

### ***Deposits***

The Bank's deposit products include demand, interest-bearing transaction accounts, money market accounts, certificates of deposit ("CDs"), municipal deposits, savings, and deposit accounts. CDs offer various maturities ranging from 30 days to five years. The Bank generates relationships by personal contacts within the conventional trading markets for such services by its officers, directors, and employees, who include persons with banking experience in these markets. The Bank also solicits local deposits through the Internet and offers Internet-only deposit accounts to supplement traditional depository accounts. Loan customers are encouraged to bring their deposit business to the Bank, including transaction accounts, CDs, and retirement accounts. This practice further increases the deposit base for the Bank and assists in controlling overall market costs related to deposit acquisition.

### ***Wealth Management/Trust Services***

The Bank has the capacity to provide wealth management services, including trust services, as the Bank is authorized to exercise trust powers, which provides the Bank with a competitive advantage. As of December 31, 2017, our wealth management and trust services division managed \$359.9 million in assets.

### ***Other Products and Services***

In order to meet all financial needs of the customers, the Bank offers retirement planning, financial planning, investment services and insurance products through its financial services department. Some of these products may be outsourced through relationships with other financial institutions.

### ***Recent Trends***

From a financial perspective, management believes the Bank has reached key milestones significantly faster than most banks in the United States during their first ten full years of operation. As of December 31, 2017, the Bank had \$2.3 billion in loans, including loans held for sale; assets of \$3.8 billion, \$3.2 billion in deposits, \$304.7 million of equity, and was number one in deposit market share in Williamson County and number two in deposit market share in Rutherford County based on deposits at June 30, 2017.

Management addresses changes in banking over recent years and embarks on new initiatives as appropriate. In the past, banks needed branches on every corner; today that is considered an outdated way of doing business. Many of the Bank's customers like to visit with personnel at the Bank, and the Bank will continue to offer a welcoming environment. Other customers prefer to bank online and through mobile channels. The Bank provides a full range of banking products and services designed to attract all types of customers.

The Bank continues to enhance banking convenience by offering the option of opening accounts online and through mobile channels (savings accounts, checking accounts and CDs). Customers can access banking services at their convenience. The Bank's remote deposit system allows consumers to deposit checks online without the need to come to a branch. Business customers enjoy this convenience as well.

Local businesses are important to the Bank. The Bank has many products that can help its corporate customers become more profitable, including sweep accounts, credit card processing, remote capture and automated lock box. A unique offering is workplace banking, which allows employers to offer a special banking benefits package to their employees. The Bank also can meet the borrowing needs of businesses through traditional working capital loans, as well as accounts receivable loans and business expansion loans. One of the Bank's specialties is customizing services to the unique needs of the business.

## **Competition**

All phases of FFN's and the Bank's business are highly competitive. FFN and the Bank are subject to intense competition from various financial institutions and other companies or firms that offer financial services. The Bank competes for deposits with other commercial banks, savings and loan associations, credit unions and issuers of commercial paper and other securities, such as money-market and mutual funds. In making loans, the Bank competes with other commercial banks, savings and loan associations, consumer finance companies, credit unions, leasing companies, and other lenders. Information about specific competition in Williamson County and Rutherford County is included under "RISK FACTORS—Competition For Deposits and Loans Is Intense, and No Assurance Can Be Given That We Will Be Successful in Our Efforts to Compete with Other Financial Institutions."

While the direction of recent and proposed federal legislation seems to favor increased competition between banks and different types of financial or other institutions for both deposits and loans, it is not possible to forecast the impact such developments may have on commercial banking in general or as to the Bank or FFN in particular. The Bank will continue to compete with these and other financial institutions, many of which have far greater assets and financial resources than the Bank and whose common stock may be more widely traded than that of FFN. See "BUSINESS—Supervision and Regulation." No assurance can be given that the Bank will be successful in its efforts to compete with such other institutions.

## **Enterprise Risk Management**

We place significant emphasis on risk mitigation as an integral component of our organizational culture. We believe that our emphasis on risk management is manifested in our solid asset quality statistics and our credit risk management procedures discussed above.

We also focus on risk management in numerous other areas throughout our organization, including with respect to asset/liability management, regulatory compliance and internal controls. We have implemented an extensive asset/liability management process aided by simulation models provided by reputable third parties. We engage in ongoing internal audit and review of all areas of our operations and regulatory compliance.

We have implemented management assessment and testing of internal controls consistent with the Sarbanes-Oxley Act and have engaged an experienced independent public accounting firm to assist us with respect to compliance.

## **Employees**

Management employs officers who have substantial experience and proven records in the banking industry and proven histories in business and commerce, and pays competitive salaries to attract and retain such persons. It is not anticipated that we will experience any substantial difficulty in attracting and retaining the desired caliber of officers and other employees. We offer a typical health and disability insurance plan to our employees and those of the Bank, as well as a 401(k) Plan and officer equity-based incentive awards.

FFN currently has eight directors and the Bank currently has 11 directors, and as of December 31, 2017, we and our bank subsidiary had 279 full-time employees and two part-time employees. We consider our relationship with our employees to be excellent. Furthermore, we are not subject to any collective bargaining agreements.

## **Trademarks**

We obtained registrations with the United States Patent and Trademark Office for the protection of the trademarks "FRANKLIN SYNERGY BANK<sup>®</sup>" and "FRANKLIN FINANCIAL NETWORK<sup>®</sup>." Management does not believe these trademarks are confusingly similar to trademarks used by other institutions in the financial services business and intends to protect the use of these trademarks nationwide.

## **Policies and Procedures**

The Board of Directors of the Bank has established a statement of lending policies and procedures being used by loan officers of the Bank when making loans. Asset quality is of utmost importance and an independent loan review process has been established to monitor the Bank's lending function. It is imperative that the Board of Directors and management have an independent and objective evaluation of the quality of specific individual loans and of the overall quality of the total portfolio.

The Board of Directors of the Bank also has established an investment policy that guides the Bank officers in determining the investment portfolio of the Bank. Other policies include a code of ethics, audit policy, loan policy, fair lending, compliance, bank secrecy, personnel and information system policies.

Under the Community Reinvestment Act of 1977 (the “CRA”), the Board of Governors of the Federal Reserve System (the “Federal Reserve”) evaluates the Bank’s record of helping to meet the credit needs of its community consistent with safe and sound operations. The Federal Reserve also takes this record into account when deciding on certain applications submitted by the Bank. The Bank’s assessment area is Williamson County, Rutherford County and Davidson County for business loans, mortgage, and general financial services.

The Bank is a fair and equal credit lender. Management’s lending objectives are to make credit products available to all segments of the Bank’s market and community. Williamson County has one moderate census tract, Davidson County has thirty-eight moderate income census tracts and twenty-nine low income tracts, and Rutherford County has seven moderate census tracts and two low census tracts. Products are being developed and marketed to individuals and businesses located in those census tracts.

## **Supervision and Regulation**

The following summaries of statutes and regulations affecting banks and their holding companies do not purport to be complete. Such summaries are qualified in their entirety by reference to the statutes and regulations described.

### ***Bank Holding Company Regulation***

FFN is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the “Holding Company Act”), and is registered with the Federal Reserve. Banking subsidiaries of bank holding companies are subject to restrictions under federal law, which limit the transfer of funds by the subsidiary banks to their respective holding companies and non-banking subsidiaries, whether in the form of loans, extensions of credit, investments or asset purchases. Under Section 23A of the Federal Reserve Act, such transfers by any subsidiary bank to its holding company or any nonbanking subsidiary are limited in amount to 10% of the subsidiary bank’s capital and surplus and, with respect to FFN and all such non-banking subsidiaries, to an aggregate of 20% of such bank’s capital and surplus. Banking subsidiaries of bank holding companies are also subject to the provisions of Section 23B of the Federal Reserve Act, which, among other things, prohibits an institution from engaging in certain transactions with certain affiliates unless the transactions are on terms substantially the same, or at least as favorable to such institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies. Furthermore, such loans and extensions of credit are required to be secured in specified amounts. The Holding Company Act also prohibits, subject to certain exceptions, a bank holding company from engaging in or acquiring direct or indirect control of more than 5% of the voting stock of any company engaged in non-banking activities. An exception to this prohibition is for activities expressly found by the Federal Reserve to be so closely related to banking or managing or controlling banks as to be a proper incident thereto, such as consumer lending and other activities that have been approved by the Federal Reserve by regulation or order. Certain servicing activities are also permissible for a bank holding company if conducted for or on behalf of the bank holding company or any of its affiliates. FFN has elected to be a financial holding company under Regulation Y, allowing FFN to engage in certain financial activities without the prior approval of the Federal Reserve.

As a bank holding company, FFN is required to file with the Federal Reserve semi-annual reports and such additional information as the Federal Reserve may require. The Federal Reserve may also make examinations of FFN and its non-bank affiliates.

According to federal law and Federal Reserve policy, bank holding companies are expected to act as a source of financial and managerial strength to each of their subsidiary banks and to commit resources to support each such subsidiary. This support may be required at times when a bank holding company may not be able to provide such support. Furthermore, in the event of a loss suffered or anticipated by the FDIC—either as a result of default of a banking or thrift subsidiary of FFN or related to FDIC assistance provided to a subsidiary in danger of default—the other banking subsidiaries of FFN may be assessed for the FDIC’s loss, subject to certain exceptions.

Regulation Y generally requires persons acting directly or indirectly or in concert with one or more persons to give the Federal Reserve 60 days advanced written notice before acquiring control of a bank holding company. Under the regulation, control is defined as the ownership or control with the power to vote 25% or more of any class of voting securities of the bank holding company. The regulation also provides for a presumption of control if a person owns, controls, or holds with the power to vote 10% or more (but less than 25%) of any class of voting securities. A bank holding company may be limited to ownership of 5% ownership of voting securities. If the person or persons making the acquisition is a company, prior approval from the Federal Reserve may be required.

Various federal and state statutory provisions limit the amount of dividends subsidiary banks can pay to their holding companies without regulatory approval. The payment of dividends by any bank also may be affected by other factors, such as the maintenance of adequate capital for such subsidiary bank. In addition to the foregoing restrictions, the Federal Reserve has the power to prohibit dividends by bank holding companies if their actions constitute unsafe or unsound practices. The Federal Reserve has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve’s view that a bank holding company experiencing earnings weaknesses should not pay cash dividends that exceed its net income or that could only be

funded in ways that weaken the bank holding company's financial health, such as by borrowing. The Federal Reserve may also order a bank holding company to terminate an activity or control of a non-bank subsidiary if such activity or control constitutes a significant risk to the financial safety, soundness, or stability of a subsidiary bank and is inconsistent with sound banking principles. Furthermore, the Tennessee Department of Financial Institutions ("TDFI") also has authority to prohibit the payment of dividends by a Tennessee bank when it determines such payment to be an unsafe and unsound banking practice.

A bank holding company and its subsidiaries are also prohibited from acquiring any voting shares of, or interest in, any banks located outside of the state in which the operations of the bank holding company's subsidiaries are located, unless the bank holding company and its subsidiaries are well-capitalized and well managed.

In approving acquisitions by holding companies of banks and companies engaged in the banking-related activities described above, the Federal Reserve considers a number of factors, including the expected benefits to the public such as greater convenience, increased competition, or gains in efficiency, as weighed against the risks of possible adverse effects such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices. The Federal Reserve is also empowered to differentiate between new activities and activities commenced through the acquisition of a going concern.

The Attorney General of the United States may, within 30 days after approval by the Federal Reserve of an acquisition, bring an action challenging such acquisition under the federal antitrust laws, in which case the effectiveness of such approval is stayed pending a final ruling by the courts. Failure of the Attorney General to challenge an acquisition does not, however, exempt the holding company from complying with both state and federal antitrust laws after the acquisition is consummated or immunize the acquisition from future challenge under the anti-monopolization provisions of the Sherman Act.

### ***Capital Guidelines***

The Federal Reserve has issued risk-based capital guidelines for bank holding companies and member banks. Under the guidelines, the minimum ratio of capital to risk-weighted assets (including certain off-balance sheet items, such as standby letters of credit) is 8%. To be considered a "well capitalized" bank or bank holding company under the guidelines, a bank or bank holding company must have a total risk-based capital ratio of 10% or greater. At least half of the total capital is to be comprised of common equity, retained earnings, and a limited amount of perpetual preferred stock, after subtracting goodwill and certain other adjustments ("Tier 1 capital"). The remainder may consist of perpetual debt, mandatory convertible debt securities, a limited amount of subordinated debt, other preferred stock not qualifying for Tier 1 capital, and a limited amount of loan loss reserves ("Tier 2 capital"). The Bank is subject to similar capital requirements adopted by the Federal Reserve. In addition, the Federal Reserve and the FDIC have adopted a minimum leverage ratio (Tier 1 capital to total assets) of 3% or 4% based on supervisory considerations. Generally, banking organizations are expected to operate well above the minimum required capital level of 3% unless they meet certain specified criteria, including that they have the highest regulatory ratings. Most banking organizations are required to maintain a leverage ratio of 3% or 4%, as applicable, plus an additional cushion of at least 1% to 2%. The guidelines also provide that banking organizations experiencing internal growth or making acquisitions are expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance upon intangible assets.

In July 2013, the federal banking regulators, in response to the statutory requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), adopted regulations implementing the Basel Capital Adequacy Accord ("Basel III"), which had been approved by the Basel member central bank governors in 2010 as an agreement among the countries' central banks and bank regulators on the amount of capital banks must hold as a cushion against losses and insolvency. The new minimum capital to risk-weighted assets ("RWA") requirements are a Common Equity Tier 1 Capital ratio of 4.5% and a Tier 1 Capital ratio of 6.0%, and a Total Capital ratio of 8.0%. The minimum leverage ratio (Tier 1 capital to total assets) is 4.0%. The new rule also changes the definition of capital, mainly by adopting stricter eligibility criteria for regulatory capital instruments, and new constraints on the inclusion of minority interests, mortgage-servicing assets, deferred tax assets, and certain investments in the capital of unconsolidated financial institutions. In addition, the new rule requires that most regulatory capital deductions be made from Common Equity Tier 1 Capital.

Under the Basel III rules, in order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers, a banking organization must hold a capital conservation buffer composed of Common Equity Tier 1 Capital above its minimum risk-based capital requirements. The buffer is measured relative to RWA. Phase-in of the capital conservation buffer requirements began on January 1, 2016 and the requirements will be fully phased in on January 1, 2019. The capital conservation buffer threshold for 2017 is 1.25%. A banking organization with a buffer greater than 2.5% once the capital conservation buffer is fully phased in would not be subject to limits on capital distributions or discretionary bonus payments; however, a banking organization with a buffer of less than 2.5% would be subject to increasingly stringent limitations as the buffer approaches zero. The rule also prohibits a banking organization from making distributions or discretionary bonus payments during any quarter if its eligible retained income is negative in that quarter and its capital conservation buffer ratio was less than 2.5% at the beginning of the quarter. Effectively, the Basel III framework will require us to meet minimum capital ratios of (i) 7% for Common Equity Tier 1 Capital, (ii) 8.5% Tier 1 Capital, and (iii) 10.5% Total Capital. The eligible retained income of a banking organization is

defined as its net income for the four calendar quarters preceding the current calendar quarter, based on the organization's quarterly regulatory reports, net of any distributions and associated tax effects not already reflected in net income. When the new rule is fully phased in, the minimum capital requirements plus the capital conservation buffer will exceed the prompt corrective action ("PCA") well-capitalized thresholds.

Under the new rule, mortgage-servicing assets and deferred tax assets are subject to stricter limitations than those applicable under the current general risk-based capital rule. More specifically, certain deferred tax assets arising from temporary differences, mortgage-servicing assets, and significant investments in the capital of unconsolidated financial institutions in the form of common stock are each subject to an individual limit of 10% of Common Equity Tier 1 Capital elements and are subject to an aggregate limit of 15% of Common Equity Tier 1 Capital elements. The amount of these items in excess of the 10% and 15% thresholds are to be deducted from Common Equity Tier 1 Capital. Amounts of mortgage-servicing assets, deferred tax assets, and significant investments in unconsolidated financial institutions that are not deducted due to the aforementioned 10% and 15% thresholds must be assigned a 250% risk weight. Finally, the new rule increases the risk weights for past-due loans, certain commercial real estate loans, and some equity exposures, and makes selected other changes in risk weights and credit conversion factors.

Failure to meet statutorily mandated capital guidelines or more restrictive ratios separately established for a financial institution could subject a banking institution to a variety of enforcement remedies available to federal regulatory authorities, including issuance of a capital directive, the termination of deposit insurance by the FDIC, a prohibition on accepting or renewing brokered deposits, limitations on the rates of interest that the institution may pay on its deposits, and other restrictions on its business.

### ***Tennessee Banking Act; Federal Deposit Insurance Act***

The Bank is incorporated under the banking laws of the State of Tennessee and, as such, is subject to the applicable provisions of those laws. The Bank is subject to the supervision of the TDFI and to regular examination by that department. The Bank is a member of the Federal Reserve and therefore is subject to Federal Reserve regulations and policies and is subject to regular exam by the Federal Reserve. The Bank's deposits are insured by the FDIC through the Deposit Insurance Fund, or "DIF," and the Bank is, therefore, subject to the provisions of the Federal Deposit Insurance Act ("FDIA").

The FDIC has adopted a risk-based assessment system for insured depository institutions that takes into account the risks attributable to different categories and concentrations of assets and liabilities. Under the Dodd-Frank Act, the FDIC was required to adopt regulations that would base deposit insurance assessments on total assets less capital rather than deposit liabilities and to include off-balance sheet liabilities of institutions and their affiliates in risk-based assessments. The Dodd-Frank Act made permanent an increase in the basic limit on federal deposit insurance coverage from \$100,000 to \$250,000 per depositor. The Dodd-Frank Act also repealed the prohibition on paying interest on demand transaction accounts, but did not extend unlimited insurance protection for these accounts.

The FDIC may terminate its insurance of deposits if it finds that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

Tennessee statutes and the federal law regulate a variety of the banking activities of the Bank, including required reserves, investments, loans, mergers and consolidations, issuances of securities, payments of dividends, and the establishment of branches. There are certain limitations under federal and Tennessee law on the payment of dividends by banks. A state bank, with the approval of the TDFI, may transfer funds from its surplus account to the undivided profits (retained earnings) account or any part of its paid-in-capital account. The payment of dividends by any bank is dependent upon its earnings and financial condition and, in addition to the limitations referred to above, is subject to the statutory power of certain federal and state regulatory agencies to act to prevent what they deem unsafe or unsound banking practices. The payment of dividends could, depending upon the financial condition of the Bank, be deemed to constitute such an unsafe or unsound practice. Also, without regulatory approval, a dividend only can be paid to the extent of the net income of the Bank for that year plus the net income of the prior two years. The FDIA prohibits a state bank, the deposits of which are insured by the FDIC, from paying dividends if it is in default in the payment of any assessments due the FDIC.

State banks also are subject to regulation respecting the maintenance of certain minimum capital levels (see above), and the Bank is required to file annual reports and such additional information as the Tennessee Banking Act and Federal Reserve regulations require. The Bank also is subject to certain restrictions on loan amounts, interest rates, "insider" loans to officers, directors and principal shareholders, tie-in arrangements, privacy, transactions with affiliates, and many other matters. Strict compliance at all times with state and federal banking laws is required.

Tennessee law contains limitations on the interest rates that may be charged on various types of loans and restrictions on the nature and amount of loans that may be granted and on the types of investments which may be made. The operations of banks are also affected by various consumer laws and regulations, including those relating to equal credit opportunity and regulation of consumer lending practices. All Tennessee banks must become and remain insured banks under the FDIA. (See 12 U.S.C. § 1811, et seq.)

Under Tennessee law, state banks are prohibited from lending to any one person, firm, or corporation amounts more than 15% of its equity capital accounts, except (i) in the case of certain loans secured by negotiable title documents covering readily marketable nonperishable staples or (ii) the Bank may make a loan to one person, firm or corporation of up to 25% of its equity capital accounts with the prior written approval of the Bank's Board of Directors or finance committee (however titled).

The TDFI and the Federal Reserve will examine the Bank periodically for compliance with various regulatory requirements. Such examinations, however, are for the protection of the DIF and for depositors and not for the protection of investors and shareholders.

### ***The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA")***

FDICIA substantially revised the depository institution regulatory and funding provisions of the FDIA, and made revisions to several other federal banking statutes. Among other things, FDICIA requires the federal banking regulators to take "prompt corrective action" in respect of FDIC-insured depository institutions that do not meet minimum capital requirements. FDICIA establishes five capital tiers: "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized." Under applicable regulations, a FDIC-insured depository institution is defined to be well capitalized if it maintains a Leverage Ratio of at least 5%, a risk adjusted Tier 1 Capital Ratio of at least 6% and a Total Capital Ratio of at least 10% and is not subject to a directive, order or written agreement to meet and maintain specific capital levels. An insured depository institution is defined to be adequately capitalized if it meets all of its minimum capital requirements as described above in the first paragraph of the section entitled "Capital Guidelines." In addition, an insured depository institution is considered undercapitalized if it fails to meet any minimum required measure; significantly undercapitalized if it has a total risk-based capital ratio of less than 6%, a tier 1 risk-based capital ratio less than 3% or a leverage ratio less than 3%; and critically undercapitalized if it fails to maintain a level of tangible equity equal to not less than 2% of total assets. An insured depository institution may be deemed to be in a capitalization category that is lower than is indicated by its actual capital position if it receives an unsatisfactory examination rating.

FDICIA generally prohibits an FDIC-insured depository institution from making any capital distribution (including payment of dividends) or paying any management fee to its holding company if the depository institution would thereafter be undercapitalized. Undercapitalized depository institutions are subject to restrictions on borrowing from the Federal Reserve. In addition, undercapitalized depository institutions are subject to growth limitations and are required to submit capital restoration plans. A depository institution's holding company must guarantee the capital plan, up to an amount equal to the lesser of 5% of the depository institution's assets at the time it becomes undercapitalized or the amount of the capital deficiency when the institution fails to comply with the plan. The federal banking agencies may not accept a capital plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution's capital. If a depository institution fails to submit an acceptable plan, it is treated as if it is significantly undercapitalized.

Significantly undercapitalized depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets and cessation of receipt of deposits from correspondent banks. Critically undercapitalized depository institutions are subject to appointment of a receiver or conservator generally within 90 days of the date on which they became critically undercapitalized.

The capital-based prompt corrective action provisions of FDICIA and their implementing regulations apply to FDIC-insured depository institutions and are not directly applicable to the holding companies which control those institutions. However, the Federal Reserve has indicated that, in regulating bank holding companies, it will take appropriate action at the holding company level based on an assessment of the effectiveness of supervisory actions imposed upon subsidiary depository institutions pursuant to these provisions and regulations.

The FDIC has adopted regulations under FDICIA governing the receipt of brokered deposits and pass-through insurance. Under the regulations, a bank cannot accept or rollover or renew brokered deposits unless it is well capitalized or it is adequately capitalized and receives a waiver from the FDIC. A bank that cannot receive brokered deposits also cannot offer "pass-through" insurance on certain employee benefit accounts. Whether or not it has obtained this waiver, an adequately capitalized bank may not pay an interest rate on any deposits in excess of 75 basis points over certain index prevailing market rates specified by regulation. There are no such restrictions on a bank that is well capitalized.

FDICIA contains numerous other provisions, including accounting, audit and reporting requirements, limitations on the FDIC's payment of deposits at foreign branches, new regulatory standards in such areas as asset quality, earnings and compensation and revised regulatory standards for, among other things, powers of state banks, real estate lending and capital adequacy. FDICIA also requires that a depository institution provide 90 days prior notice of the closing of any branches.



## ***The Dodd-Frank Act***

In July 2010, the Dodd-Frank Act was signed into law, incorporating numerous financial institution regulatory reforms. Many of these reforms were implemented over the course of 2011-2013 and continue to be implemented through regulations being adopted by various federal banking and securities regulations. The following discussion describes the material elements of the regulatory framework. Many of the Dodd-Frank Act provisions are stated to only apply to larger financial institutions and do not directly impact community-based institutions like the Bank. For instance, provisions that regulate derivative transactions and limit derivatives trading activity of federally-insured institutions, enhance supervision of “systemically significant” institutions, impose new regulatory authority over hedge funds, limit proprietary trading by banks, and phase-out the eligibility of trust preferred securities for Tier 1 capital are among the provisions that do not directly impact the Bank either because of exemptions for institutions below a certain asset size or because of the nature of the Bank’s operations. Other provisions that have impacted or will impact the Bank:

- Change the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital, eliminate the ceiling and increase the size of the floor of the DIF, and offset the impact of the increase in the minimum floor on institutions with less than \$10 billion in assets.
- Make permanent the \$250,000 limit for federal deposit insurance.
- Repeal the federal prohibition on payment of interest on demand deposits, thereby permitting depositing institutions to pay interest on business transaction and other accounts.
- Centralize responsibility for consumer financial protection by creating the Consumer Financial Protection Bureau (the “CFPB”), responsible for implementing federal consumer protection laws, although banks below \$10 billion in assets will continue to be examined and supervised for compliance with these laws by their federal bank regulator.
- Restrict the preemption of state law by federal law and disallow national bank subsidiaries from availing themselves of such preemption.
- Impose new requirements for mortgage lending, including new minimum underwriting standards, prohibitions on certain yield-spread compensation to mortgage originators, special consumer protections for mortgage loans that do not meet certain provision qualifications, prohibitions and limitations on certain mortgage terms and various new mandated disclosures to mortgage borrowers.
- Apply the same leverage and risk based capital requirements that apply to insured depository institutions to holding companies.
- Permit national and state banks to establish de novo interstate branches at any location where a bank based in that state could establish a branch, and require that bank holding companies and banks be well-capitalized and well managed in order to acquire banks located outside their home state.
- Impose new limits on affiliated transactions and cause derivative transactions to be subject to lending limits.
- Implement corporate governance revisions, including with regard to executive compensation and proxy access to shareholders that apply to all public companies not just financial institutions.

## ***FDIC Insurance Premiums***

The Bank is required to pay quarterly FDIC deposit insurance assessments to the DIF. The FDIC maintains the DIF by assessing depository institutions an insurance premium. The amount each institution is assessed is based upon statutory factors that include the balance of insured deposits as well as the degree of risk the institution poses to the insurance fund. The FDIC uses a risk-based premium system that assesses higher rates on those institutions that pose greater risks to the DIF.

On March 15, 2016, the FDIC adopted a rule in accordance with provisions of the Dodd-Frank Act that requires large institutions to bear the burden of raising the Reserve Ratio from 1.15% to 1.35%. Since the Reserve Ratio has reached 1.15%, the FDIC will collect assessment surcharges from large institutions. Once the reserve ratio reaches 1.38%, small institutions will receive credits to offset their contribution to raising the Reserve Ratio to 1.35%. On April 26, 2016, the FDIC Board of Directors approved the final rule to improve the deposit insurance assessment system for established small insured depository institutions (generally, those banks with less than \$10 billion in total assets that have been insured for at least five years). The final rule was effective July 1, 2016. Since the reserve ratio of the DIF reached 1.15 percent before that date, the final rule determined assessment rates beginning July 1, 2016. Effective July 1, 2016, the initial base assessment rates for all insured institutions were reduced from 5 to 35 basis points to 3 to 30 basis points. Total base assessment rates after possible adjustments were reduced from 2.5 to 45 basis points to 1.5 to 40 basis points. Although the base assessment rates were reduced, the assessment calculation includes pricing adjustments for certain financial

ratios that relate to asset growth, loan mix, funding ratios, and nonperforming assets, which in the case of the Bank, have adversely impacted the Company's earnings due to increased premium assessments. Additional increases in premiums will impact FFN's earnings adversely. Depending on any future losses that the FDIC insurance fund may suffer due to failed institutions, there can be no assurance that there will not be additional significant premium increases in order to replenish the fund.

Under the FDIA, insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by a federal bank regulatory agency.

### ***The CRA***

The CRA requires that, in connection with examinations of financial institutions within its jurisdiction, the FDIC and the state banking regulators, as applicable, evaluate the record of each financial institution in meeting the credit needs of its local community, including low and moderate-income neighborhoods. These facts are also considered in evaluating mergers, acquisitions and applications to open a branch or facility. Failure to adequately meet these criteria could impose additional requirements and limitations on us. Additionally, we must publicly disclose the terms of various CRA-related agreements.

### ***Other Regulations***

Interest and other charges that our subsidiary bank collects or contracts for are subject to state usury laws and federal laws concerning interest rates. Our bank's loan operations are also subject to federal laws applicable to credit transactions, such as:

- The federal Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- The Home Mortgage Disclosure Act, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- The Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- The Fair Credit Reporting Act, governing the use and provision of information to credit reporting agencies;
- The Fair Debt Collection Practices Act, governing the manner in which consumer debts may be collected by collection agencies; and
- The rules and regulations of the various governmental agencies charged with the responsibility of implementing these federal laws.

In addition, our bank subsidiary's deposit operations are subject to the Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve to implement this act, which governs automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services.

### ***Effects of Governmental Policies***

The Bank's earnings are affected by the difference between the interest earned by the Bank on its loans and investments and the interest paid by the Bank on its deposits or other borrowings. The yields on its assets and the rates paid on its liabilities are sensitive to changes in prevailing market rates of interest. Thus, the earnings and growth of the Bank are influenced by general economic conditions, fiscal policies of the federal government, and the policies of regulatory agencies, particularly the Federal Reserve, which establishes national monetary policy. The nature and impact of any future changes in fiscal or monetary policies cannot be predicted.

Commercial banks are affected by the credit policy of various regulatory authorities, including the Federal Reserve. An important function of the Federal Reserve is to regulate the national supply of bank credit. Among the instruments of monetary policy used by the Federal Reserve to implement these objectives are open market operations in U.S. Government securities, changes in reserve requirements on bank deposits, changes in the discount rate on bank borrowings and limitations on interest rates that banks may pay on time and savings deposits. The Federal Reserve uses these means in varying combinations to influence overall growth of bank loans, investments and deposits, and also to affect interest rates charged on loans, received on investments or paid for deposits.

The monetary and fiscal policies of regulatory authorities, including the Federal Reserve, also affect the banking industry. Through changes in the reserve requirements against bank deposits, open market operations in U.S. Government securities and changes in the discount rate on bank borrowings, the Federal Reserve influences the cost and availability of funds obtained for lending and investing. No prediction can be made with respect to possible future changes in interest rates, deposit levels or loan demand or with respect to the impact of such changes on the business and earnings of the Bank.

From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities, or affecting the competitive balance between banks and other financial institutions. The nature and extent of the future legislative and regulatory changes affecting financial institutions and the resulting impact on those institutions is very unpredictable at this time. Bills are currently pending which may have the effect of changing the way the Bank conducts its business.

## **Recent Developments**

### ***Civic Acquisition***

As previously disclosed, FFN and the Bank entered into an Agreement and Plan of Reorganization and Bank Merger with Civic on December 14, 2015, as amended by Amendment No. 1 thereto, dated May 9, 2016, Amendment No. 2 thereto, dated March 30, 2017, and Amendment No. 3 thereto, dated September 29, 2017 (the "Merger Agreement"). Under the terms of the Merger Agreement, Civic will merge with and into the Bank, with the Bank as the surviving Tennessee banking corporation (the "Civic Merger"). We received the approval of the TDFI on April 13, 2016 and approval from the Federal Reserve Board (FRB) on December 28, 2017. The proposed merger has been approved by each company's Board of Directors, and is subject to approval by Civic's shareholders. Civic has called a special meeting of shareholders to be held on March 30, 2018 at 10:00 a.m. Central Time at the main office of Civic, located at 3325 West End Avenue, Nashville, Tennessee 37203, for approval of the merger.

### ***New Offices and Branches***

During 2017, the Bank relocated its Spring Hill branch in Williamson County to 4824 Main Street, Suite A, Spring Hill, Tennessee 37174, and opened a new branch in Murfreesboro, Tennessee in Rutherford County, located at 1605 Medical Center Parkway, Murfreesboro, Tennessee 37129.

## **Available Information**

Our website is located at [www.franklinsynergybank.com](http://www.franklinsynergybank.com). We make available free of charge through this website our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed with or furnished to the SEC pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after they are electronically filed with or furnished to the SEC. Reference to our website does not constitute incorporation by reference of the information contained on the site and should not be considered part of this document.

All filings made by us with the SEC may be copied or read at the SEC's Public Reference Room at 100 F Street NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC as we do. The website is <http://www.sec.gov>.

## **ITEM 1A. RISK FACTORS.**

Our business and its future performance may be affected by various factors, the most significant of which are discussed below.

### **Risks Related to Our Business**

#### ***We May Not Be Able to Implement Our Growth Strategy Effectively***

Our business has grown quickly. Furthermore, our strategy focuses on organic growth, supplemented by opportunistic acquisitions. We may not be able to execute aspects of our growth strategy to sustain our historical rate of growth or may not be able to grow at all. More specifically, we may not be able to generate sufficient new loans and deposits within acceptable risk and expense tolerances, obtain the personnel or funding necessary for additional growth or find suitable acquisition candidates. Various factors, such as economic conditions and competition, may impede or prohibit the growth of our operations, the opening of new branches and the consummation of acquisitions.

#### ***Competition For Deposits and Loans Is Intense, and No Assurance Can Be Given That We Will Be Successful in Our Efforts to Compete with Other Financial Institutions***

The commercial banking industry in Williamson County, Tennessee consists of 32 banks and two savings and loan institutions, with 104 total offices and total deposits of \$8.9 billion as of June 30, 2017, which is the most recent date such information has been released by the FDIC. The commercial banking industry in Rutherford County, Tennessee consists of 22 banks and no savings and loan institutions, with 75 total offices and total deposits of \$4.2 billion as of June 30, 2017, which is the most recent date such information has been released by the FDIC. Offices affiliated with out-of-state financial institutions have entered Tennessee in recent

years to offer all financial services, including lending and deposit gathering activities. Also, changes to laws on interstate banking and branching now permit banks and bank holding companies headquartered outside Tennessee to move into Williamson County and Rutherford County more easily. In addition, there are credit unions, finance companies, securities brokerage firms, and other types of businesses offering financial services. Technological advances and the growth of e-commerce have made it possible for non-financial institutions to offer products and services that traditionally have been offered by banking institutions. Competition for deposit and loan opportunities in our market area is expected to be intense because of existing competitors and the geographic expansion into the market area by other institutions. See “BUSINESS—Supervision and Regulation.” No assurance can be given that we will be successful in our efforts to compete with other such institutions.

### ***We Face Risks Related to Our Commercial Real Estate Loan Concentrations***

Commercial real estate (“CRE”) is cyclical and poses risks of possible loss due to concentration levels and similar risks of the asset class. As of December 31, 2017, approximately 52% of our loan portfolio consisted of CRE loans, including 22% of construction and land development (“CLD”) loans, which present additional risks including underwriting risks, project risks and market risks. The banking regulators give CRE lending greater scrutiny, and in connection with the MOU, has required us to implement improved underwriting, internal controls, risk management policies and portfolio stress testing, as well as possibly requiring a re-assessment of allowances for possible loan losses and capital levels as a result of CRE lending growth and exposures. In addition, while we believe we have appropriate systems in place to underwrite and monitor the risks associated with CLD loans, if these systems do not adequately protect us from these risks, we could incur losses that exceed our reserves for such losses, which could adversely impact our earnings.

### ***There Can Be No Assurance That the Bank Will Not Incur Excessive Loan Losses***

An allowance for loan losses account is accumulated through monthly provisions against income. This account is a valuation allowance established for probable incurred credit losses inherent in the loan portfolio. Banks are susceptible to risks associated with their loan portfolios. The Bank’s loan customers may include a disproportionate number of individuals and entities seeking to establish a new banking relationship because they are dissatisfied with the amount or terms of credit offered by their current banks, or they may have demonstrated less than satisfactory performance in previous banking relationships. If the Bank lends to individuals who have demonstrated less than satisfactory performance in previous banking relationships, the Bank could experience disproportionate loan losses, which could have a significantly negative impact on the Bank’s earnings. Although management is aware of the potential risks associated with extending credit to customers with whom they have not had a prior lending relationship, there can be no assurance that the Bank will not incur excessive loan losses. Bank regulators may disagree with the Bank’s characterization of the collectability of loans and may require the Bank to downgrade credits and increase our provision for loan losses that would negatively impact results of operations and capital levels.

### ***Changes in Interest Rates May Reduce the Bank’s Profitability***

We incur interest rate risk. The Bank’s profitability is dependent, to a large extent, upon net interest income, which is the difference between its interest income on interest-earning assets, such as loans and investment securities and interest expense on interest-bearing liabilities, such as deposits and borrowings. The Bank will continue to be affected by changes in interest rates and other economic factors beyond its control, particularly to the extent that such factors affect the overall volume of our lending and deposit activities. The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are “interest rate sensitive” and by monitoring an institution’s interest rate sensitivity “gap.” An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period. The interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets maturing or repricing within a specific time period and the amount of interest-bearing liabilities maturing or repricing within that time period. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities. A gap is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. During a period of rising interest rates, a negative gap would tend to adversely affect net interest income while a positive gap would tend to result in an increase in net interest income. During a period of falling interest rates, a negative gap would tend to result in an increase in net interest income while a positive gap would tend to adversely affect net interest income. Furthermore, an increase in interest rates may negatively affect the market value of securities in our investment portfolio. A reduction in the market value of our portfolio will increase the unrealized loss position of our available-for-sale investments. Any of these events could materially adversely affect our results of operations or financial condition.

### ***If We Fail to Effectively Manage Credit Risk and Interest Rate Risk, Our Business and Financial Condition Will Suffer***

We must effectively manage credit risk. There are risks inherent in making any loan, including risks with respect to the period of time over which the loan may be repaid, risks relating to proper loan underwriting and guidelines, risks resulting from changes in economic and industry conditions, risks inherent in dealing with individual borrowers and risks resulting from uncertainties as to the

future value of collateral. There is no assurance that our credit risk monitoring and loan approval procedures are, or will be, adequate or will reduce the inherent risks associated with lending. Our credit administration personnel, policies and procedures may not adequately adapt to changes in economic or any other conditions affecting customers and the quality of our loan portfolio. Any failure to manage such credit risks may materially adversely affect our business and our consolidated results of operations and financial condition.

***The Bank Depends on Its Ability to Attract Deposits***

The acquisition of local deposits is a primary objective of the Bank. If customers move money out of bank deposits and into other investments, we would lose a relatively low-cost source of funds, increasing our funding costs and reducing our net interest income and net income. In addition to the traditional deposit accounts solicited in its community, the Bank also solicits local deposits through the Internet and will offer Internet-only deposit accounts to supplement traditional depository accounts. The Bank is a member of the FHLB for use as a general funding source and may use Internet funds and brokered deposits to balance funding needs. The ability of the Bank to accept brokered deposits is dependent on its ability to remain “well capitalized.”

***The Bank May Be Required to Rely on Secondary Sources of Liquidity to Meet Withdrawal Needs or Fund Operations, and There Can Be No Assurance That These Sources Will Be Sufficient to Meet Future Liquidity Demands***

The primary source of the Bank’s funds is customer deposits and loan repayments. While scheduled loan repayments are a relatively stable source of funds, they are subject to the ability of borrowers to repay the loans. The ability of borrowers to repay loans can be adversely affected by a number of factors, including changes in general economic conditions, adverse trends or events affecting business industry groups, reductions in real estate values or markets, business closings or lay-offs, inclement weather, natural disasters and international instability. Additionally, deposit levels may be affected by a number of factors, including rates paid by competitors, general interest rate levels, returns available to customers on alternative investments and general economic conditions. Accordingly, the Bank may be required from time to time to rely on secondary sources of liquidity to meet withdrawal demands or otherwise fund operations. These sources include Internet funds, brokered certificates of deposit, investment securities, borrowings from the Federal Reserve, FHLB advances, and federal funds lines of credit from correspondent banks. While management believes that these sources are currently adequate, there can be no assurance that they will be sufficient to meet future liquidity demands. The Bank may be required to slow or discontinue loan growth, capital expenditures or other investments or liquidate assets should these sources not be adequate.

***Economic Challenges, Especially Those Affecting the Local Economy Where We Operate, Could Affect Our Financial Condition and Results of Operations***

If the communities in which we operate do not grow or if prevailing local or national economic conditions are unfavorable, our business may not succeed. Adverse economic conditions to the extent they develop in our primary market area, which currently is limited to Williamson County and Rutherford County, Tennessee and the surrounding areas, could reduce our growth rate, affect the ability of our customers to repay their loans, and generally affect our financial condition and results of operations. Moreover, management cannot give any assurance that we will benefit from any market growth or favorable economic conditions in our primary market area if they do occur. Continued adverse market or economic conditions may increase the risk that the Bank’s borrowers will be unable to timely make their loan payments. Furthermore, even if the Bank’s borrowers continue to make timely loan payments, a deterioration in the real estate market could cause a decline in the appraised values of such mortgaged properties. In the event of such a deterioration, the Bank may be forced to write down the value of the loans, which could have a negative effect on the Bank’s capital ratios and earnings.

The Bank’s loan portfolio is real-estate focused. While real estate lending is the expertise of our lending staff and management, risks associated with this type of lending are heavily influenced by the economic environment. In addition, the market value of the real estate securing loans as collateral could be adversely affected by unfavorable changes in market and economic conditions.

As of December 31, 2017, approximately 78% of the Bank’s total loans were real-estate secured. One-to-four family residential properties accounted for 26% of the Bank’s portfolio, owner-occupied commercial real estate was 9% and other commercial real estate was 19% of the total loan portfolio. Total construction and land development lending accounted for 22% of total loans with residential construction lending totaling 14%, commercial construction lending totaling 4% and land development lending totaling 4%. Other real estate lending, including multi-family and farmland, accounted for 2% of the total loan portfolio. A sustained period of increased payment delinquencies, foreclosures, or losses caused by adverse market or economic conditions in the state of Tennessee, or more specifically the Bank’s market area in Williamson County and Rutherford County in Middle Tennessee, could adversely affect the value of our assets, revenues, results of operations, and financial condition.

### ***Our Financial Condition and Results of Operations Could be Affected if Long-Term Business Strategies Are Not Effectively Executed***

Although the Bank's primary focus in the near term will be organically growing its balance sheet, over the longer term, management may pursue a growth strategy for the Bank's business through de novo branching. The Bank's prospects must be considered in light of the risks, expenses, and difficulties occasionally encountered by financial services companies in growth stages, which may include the following:

- **Operating Results:** There is no assurance that existing offices or future offices will maintain or achieve deposit levels, loan balances, or other operating results necessary to avoid losses or produce profits. The Bank's growth strategy necessarily entails growth in overhead expenses as it routinely adds new offices and staff. Historical results may not be indicative of future results or results that may be achieved as the Bank continues to increase the number and concentration of the Bank's branch offices.
- **Development of Offices:** There are considerable costs involved in opening branches, and new branches generally do not generate sufficient revenues to offset their costs until they have been in operation for at least a year or more. Accordingly, de novo branches may be expected to negatively impact earnings during this period of time until the branches reach certain economies of scale.
- **Regulatory and Economic Factors:** Growth and expansion plans may be adversely affected by a number of regulatory and economic developments or other events. Failure to obtain required regulatory approvals, changes in laws and regulations, or other regulatory developments and changes in prevailing economic conditions or other unanticipated events may prevent or adversely affect continued growth and expansion. Failure to successfully address the issues identified above could have a material adverse effect on the Bank's business, future prospects, financial condition, or results of operations, and could adversely affect the Bank's ability to successfully implement its longer term business strategy.

### ***The Accuracy of Our Financial Statements and Related Disclosures Could be Affected if the Judgments, Assumptions or Estimates Used in Our Critical Accounting Policies are Inaccurate***

The preparation of financial statements and related disclosure in conformity with accounting principles generally accepted in the United States requires us to make judgments, assumptions and estimates that affect the amounts reported in our consolidated financial statements and accompanying notes. Our critical accounting policies, which are included in the section entitled "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS" in this report, describe those significant accounting policies and methods used in the preparation of our consolidated financial statements that we consider "critical" because they require judgments, assumptions and estimates that materially affect our consolidated financial statements and related disclosures. As a result, if future events differ significantly from the judgments, assumptions and estimates in our critical accounting policies, those events or assumptions could have a material impact on our consolidated financial statements and related disclosures.

### ***Negative Public Opinion or Failure to Maintain Our Reputation in the Communities We Serve Could Adversely Affect Our Business and Prevent Us from Growing Our Business***

As a community bank, our reputation within the communities we serve is critical to our success. We have set ourselves apart from our competitors by building strong personal and professional relationships with our customers and by being an active member of the communities we serve. As such, we strive to enhance our reputation by recruiting, hiring and retaining employees who share our core values of being an integral part of the communities we serve and delivering superior service to our customers. If our reputation is negatively affected by the actions of our employees or otherwise, we may be less successful in attracting new customers, and our business, financial condition, results of operations and prospects could be materially and adversely affected. Further, negative public opinion can expose us to litigation and regulatory action as we seek to implement our growth strategy, such as delays in regulatory approval based on unfounded complaints, which could impede the timeliness of regulatory approval for acquisitions we may make.

### ***The Obligations Associated with Being a Public Company Require Significant Resources and Management Attention, Which Could Increase Our Costs of Operations and May Divert Focus from Our Business Operations***

As a public company, we are required to file periodic reports containing our consolidated financial statements with the SEC within a specified time following the completion of quarterly and annual periods. As a public company, we also incur significant legal, accounting, insurance and other expenses. Compliance with these reporting requirements and other rules of the SEC and the rules of the New York Stock Exchange ("NYSE") or any exchange on which our common stock may be listed in the future could increase our legal and financial compliance costs and make some activities more time consuming and costly. Furthermore, the need to maintain the corporate infrastructure demanded of a public company may divert management's attention from implementing our growth strategy, which could prevent us from successfully implementing our strategic initiatives and improving our business, results of operations and financial condition. We have made, and will continue to make, changes to our internal controls and procedures for financial reporting

and accounting systems to meet our reporting obligations as a public company. However, we cannot predict or estimate the amount of additional costs we may incur in order to comply with these requirements. We anticipate that these costs will materially increase our general and administrative expenses.

***If We Fail to Correct Any Material Weakness That We Identify in Our Internal Control over Financial Reporting or Otherwise Fail to Maintain Effective Internal Control over Financial Reporting, We May Not Be Able to Report Our Financial Results Accurately and Timely***

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

If we identify material weaknesses in our internal control over financial reporting in the future and we cannot comply with the requirements of the Sarbanes-Oxley Act in a timely manner or attest that our internal control over financial reporting is effective, or if our independent registered public accounting firm cannot express an opinion as to the effectiveness of our internal control over financial reporting when required, we may not be able to report our financial results accurately and timely. As a result, investors, counterparties and customers may lose confidence in the accuracy and completeness of our financial reports; our liquidity, access to capital markets and perceptions of our creditworthiness could be adversely affected; and the market price of our common stock could decline. In addition, we could become subject to investigations by the stock exchange on which our securities are listed, the SEC, the Federal Reserve, the FDIC, or other regulatory authorities, which could require additional financial and management resources. These events could have an adverse effect on our business, financial condition and results of operations.

***A Failure in, or Breach of, Our Operational or Security Systems or Infrastructure, or Those of Our Third Party Vendors and Other Service Providers or Other Third Parties, Including as a Result of Cyber Attacks, Could Disrupt Our Businesses, Result in the Disclosure or Misuse of Confidential or Proprietary Information, Damage Our Reputation, Increase Our Costs, and Cause Losses***

We rely heavily on communications and information systems to conduct our business. Information security risks for financial institutions such as us have generally increased in recent years in part because of the proliferation of new technologies, the use of the Internet and telecommunications technologies to conduct financial transactions, and the increased sophistication and activities of organized crime, hackers, and terrorists, activists, and other external parties. As customer, public, and regulatory expectations regarding operational and information security have increased, our operating systems and infrastructure must continue to be safeguarded and monitored for potential failures, disruptions, and breakdowns. Our business, financial, accounting, and data processing systems, or other operating systems and facilities, may stop operating properly or become disabled or damaged as a result of a number of factors, including events that are wholly or partially beyond our control. For example, there could be electrical or telecommunication outages; natural disasters such as earthquakes, tornadoes, and hurricanes; disease pandemics; events arising from local or larger scale political or social matters, including terrorist acts; and as described below, cyber attacks.

Our business relies on its digital technologies, computer and email systems, software and networks to conduct its operations. Although we have information security procedures and controls in place, our technologies, systems and networks and our customers’ devices may become the target of cyber attacks or information security breaches that could result in the unauthorized release, gathering, monitoring, misuse, loss, or destruction of our or our customers’ or other third parties’ confidential information. Third parties with whom we do business or who facilitate our business activities, including financial intermediaries, or vendors that provide service or security solutions for our operations, and other unaffiliated third parties, could also be sources of operational and information security risk to us, including from breakdowns or failures of their own systems or capacity constraints. In addition, hardware, software or applications we develop or procure from third parties may contain defects in design or manufacture or other problems that could unexpectedly compromise information security.

While we have disaster recovery and other policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately addressed. Our risk and exposure to these matters remain heightened because of the evolving nature of these threats. As a result, cyber security and the continued development and enhancement of our controls, processes, and practices designed to protect our systems, computers, software, data, and networks from

attack, damage or unauthorized access remain a focus for us. As threats continue to evolve, we may be required to expend additional resources to continue to modify or enhance our protective measures or to investigate and remediate information security vulnerabilities. Disruptions or failures in the physical infrastructure or operating systems that support our businesses and clients, or cyber attacks or security breaches of the networks, systems or devices that our clients use to access our products and services, could result in client attrition, regulatory fines, penalties or intervention, reputation damage, reimbursement or other compensation costs, and/or additional compliance costs, any of which could have a material effect on our results of operations or financial condition. Furthermore, if such attacks are not detected immediately, their effect could be compounded. To date, to our knowledge, we have not experienced any material impact relating to cyber-attacks or other information security breaches.

### ***The Bank Is Subject to General Banking Risks***

Several risks are inherent in the business of banking. Factors outside the Bank's control, such as instability in interest rates, a depressed economy, government regulation, and federal monetary policy, for example, could adversely impact the banking industry. Banks are also exposed to risk of loss as a result of fraud, embezzlement, insider abuse, and mismanagement. Extensions of credit create a risk that loans cannot, or will not, be repaid.

Earnings are affected by the ability of the Bank to properly originate, underwrite and service loans. The Bank could sustain losses if it incorrectly assesses the creditworthiness of its borrowers or fails to detect or respond to deterioration in asset quality in a timely manner. Rapid changes in loan and deposit terms could result in a risk of loss from changes in interest rates. In managing its loans and investments (assets) and its borrowings and deposits (liabilities), the Bank will run the risk of having insufficient liquid assets to meet withdrawal requests.

Beyond general banking risk, we will take limited risk in mortgage banking, wealth management, trust services or other financial services being offered. Such risks could have a material adverse effect on our business, financial condition, results of operations and prospects.

### ***Because We Engage in Lending Secured By Real Estate and May Be Forced to Foreclose on the Collateral Property and Own The Underlying Real Estate, We May Be Subject to the Increased Costs and Risk Associated with the Ownership of Real Property, Which Could Have an Adverse Effect on Our Business or Results of Operations***

A significant portion of our loan portfolio is secured by real estate property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans, in which case, we are exposed to the risks inherent in the ownership of real estate. The amount that we, as a mortgagee, may realize after a default is dependent upon factors outside of our control, including:

- general or local economic conditions;
- environmental cleanup liability;
- neighborhood values;
- interest rates;
- real estate tax rates;
- operating expenses of the mortgaged properties;
- supply of and demand for rental units or properties;
- ability to obtain and maintain adequate occupancy of the properties;
- zoning laws;
- governmental rules, regulations and fiscal policies; and
- tornadoes or other natural or man-made disasters.

Certain expenditures associated with the ownership of real estate, principally real estate taxes and maintenance costs, may also adversely affect our operating expenses.

### ***We Are Subject to Environmental Liability Risk Associated with Lending Activities***

A significant portion of our loan portfolio is secured by real estate, and we could become subject to environmental liabilities with respect to one or more of these properties. During the ordinary course of business, we may foreclose on and take title to properties securing defaulted loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous conditions or toxic substances are found on these properties, we may be liable for remediation costs, as well as for personal



injury and property damage, civil fines and criminal penalties regardless of when the hazardous conditions or toxic substances first affected any particular property. Environmental laws may require us to incur substantial expenses to address unknown liabilities and may materially reduce the affected property's value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although we have policies and procedures to perform an environmental review before initiating any foreclosure action on nonresidential real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on us.

***Our Loan Portfolio Includes a Meaningful Amount of Real Estate Construction and Development Loans, Which Have a Greater Credit Risk Than Residential Mortgage Loans***

The percentage of loans in real estate construction and development in our portfolio was approximately 22% of total loans at December 31, 2017. This type of lending is generally considered to have relatively high credit risks because the principal is concentrated in a limited number of loans with repayment dependent on the successful completion and operation of the related real estate project. The credit quality of many of these loan types deteriorated during the challenging economic period of 2008 to 2012 due to the adverse conditions in the real estate market during that period and that type of deterioration could occur again. Weakness in residential real estate market prices in the Middle Tennessee area as well as demand could result in price reductions in home and land values adversely affecting the value of collateral securing the construction and development loans that we hold. Should we experience the return of these adverse economic and real estate market conditions we may experience increases in non-performing loans and other real estate owned, increased losses and expenses from the management and disposition of non-performing assets ("NPAs"), increases in provision for loan losses, and increases in operating expenses as a result of the allocation of management time and resources to the collection and work out of loans, all of which would negatively impact our financial condition and results of operations.

***If We Are Unable to Decrease Our Use of Out of Market and Brokered Deposits, Our Costs May Be Higher Than Expected***

Although we are increasing our effort to decrease our use of non-core funding sources, we can offer no assurance that we will be able to increase our market share of core-deposit funding in our highly competitive service areas. If we are unable to do so, we may be forced to accept increased amounts of out of market or brokered deposits. As of December 31, 2017, we had approximately \$780.8 million in out of market brokered deposits, which represented approximately 24.7% of our total deposits. The cost of out of market and brokered deposits typically exceeds the cost of deposits in our local markets which will decrease our net income. In addition, the cost of out of market and brokered deposits can be volatile, and if we are unable to access these types of deposits or if our costs related to out of market and brokered deposits increases, our liquidity and ability to support demand for loans could be adversely affected.

***We Are Dependent on Key Personnel***

We are materially dependent on the performance of our executive management team, loan officers, and other support personnel. The loss of the services of any of these employees could have a material adverse effect on our business, results of operations, and financial condition. Many of these key officers have important customer relationships, which are instrumental to the Bank's operations. Changes in key personnel and their responsibilities may be disruptive to our business and could have a material adverse effect on our business, financial condition, and results of operations. Management believes that future results also will depend, in part, upon attracting and retaining highly skilled and qualified management, especially in the new market areas into which we may enter, as well as in sales and marketing personnel. Competition for such personnel is intense, and management cannot be sure that we will be successful in attracting or retaining such personnel.

***The Amount of Interest Payable on the March 2016 Notes Will Vary Beginning on March 30, 2021***

On March 31, 2016, we completed the public offering of \$40,000,000 aggregate principal amount of fixed-to-floating rate subordinated Notes due 2026 (the "March 2016 Notes"). The net proceeds from the offering of the March 2016 Notes was used, in part, to pay down a line of credit, which we used on March 25, 2016 to redeem 10,000 outstanding shares of our Series A Preferred Stock issued to the Treasury pursuant to our participation in the Small Business Lending Fund program.

The interest rate on the March 2016 Notes will vary beginning on March 30, 2021. From and including the date of issuance of the March 2016 Notes, to but excluding March 30, 2021, the March 2016 Notes will bear interest at an initial rate of 6.875% per annum. From and including March 30, 2021 and thereafter, the March 2016 Notes will bear interest at a floating rate equal to three-month LIBOR as calculated on each applicable date of determination, plus a spread of 5.636%. If interest rates rise, the cost of the March 2016 Notes may increase, thereby negatively affecting our net income.

### ***The Amount of Interest Payable on the June 2016 Notes Will Vary Beginning on July 1, 2021***

On June 30, 2016, we completed the private offering of \$20,000,000 aggregate principal amount of fixed-to-floating rate subordinated Notes due 2026 (the “June 2016 Notes”). The net proceeds from the offering of the June 2016 Notes were used to inject capital into Franklin Synergy Bank, the Company’s primary subsidiary, to fund growth and for other corporate purposes.

The interest rate on the June 2016 Notes will vary beginning on July 1, 2021. From and including the date of issuance of the June 2016 Notes, to and including June 30, 2021, the June 2016 Notes will bear interest at an initial rate of 7.00% per annum. From and including July 1, 2021 and thereafter, the June 2016 Notes will bear interest at a floating rate equal to three-month LIBOR as calculated on each applicable date of determination, plus a spread of 6.04%. If interest rates rise, the cost of the June 2016 Notes may increase, thereby negatively affecting our net income.

### **Risks Related to the Regulation of Our Business**

#### ***We Are Subject to Extensive Regulation***

We are subject to extensive governmental regulation and control. Compliance with state and federal banking laws has a material effect on our business and operations. Our operations will at all times be subject to state and federal banking laws, regulations, and procedures. The laws and regulations applicable to the banking industry could change at any time and are subject to interpretation, and management cannot predict the effects of these changes on our business and profitability. Because government regulation greatly affects the business and financial results of all commercial banks and bank holding companies, the cost of compliance could adversely affect our ability to operate profitably. Non-banking financial institutions, such as securities brokerage firms, insurance companies, and money market funds are now permitted to offer services which compete directly with services offered by banks. See “BUSINESS—Supervision and Regulation.”

#### ***The Regulatory Environment for the Financial Services Industry Is Being Significantly Impacted by Financial Regulatory Reform Initiatives, Which May Adversely Impact Our Business, Results of Operations and Financial Condition.***

The Dodd-Frank Act contains comprehensive provisions governing the practices and oversight of financial institutions and other participants in the financial markets. See “BUSINESS—Supervision and Regulation.” The Dodd-Frank Act established, among other requirements, a new financial industry regulator, the CFPB, to centralize responsibility for consumer financial protection with broad rulemaking authority to administer and carry out the purposes and objectives of the “Federal consumer financial laws and to prevent evasions thereof,” with respect to all financial institutions that offer financial products and services to consumers, including deposit products, residential mortgages, home-equity loans and credit cards and contains provisions on mortgage-related matters, such as steering incentives, determinations as to a borrower’s ability to repay and prepayment penalties. The CFPB is also authorized to prescribe rules applicable to any covered person or service provider, identifying and prohibiting “unfair, deceptive, or abusive acts or practices” in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service (“UDAAP authority”). The ongoing broad rulemaking powers of the CFPB and its UDAAP authority have the potential to have a significant impact on the operations of financial institutions offering consumer financial products or services. The CFPB has indicated that they are examining proposing new rules on overdrafts and other consumer financial products or services and if any such rule limits our ability to provide such financial products or services it may have an adverse effect on our business. Additional legislative or regulatory action that may impact our business may result from the multiple studies mandated under the Dodd-Frank Act. Although the applicability of certain elements of the Dodd-Frank Act is limited to institutions with more than \$10 billion in assets, there can be no guarantee that such applicability will not be extended in the future or that regulators or other third parties will not seek to impose such requirements on institutions with less than \$10 billion in assets. Finally, President Donald Trump and the Congressional majority have indicated that the Dodd-Frank Act will be under further scrutiny and some of the provisions of the Dodd-Frank Act rules promulgated thereunder may be revised, repealed or amended. We cannot predict with any degree of certainty what impact, if any, these or future reforms will have on our business, financial condition, or results of operations.

The evolving regulatory environment causes uncertainty with respect to the manner in which we conduct our businesses and requirements that may be imposed by our regulators. Regulators have implemented and continue to propose new regulations and issue supervisory guidance and have been increasing their examination and enforcement action activities. We expect that regulators will continue taking formal enforcement actions against financial institutions in addition to addressing supervisory concerns through non-public supervisory actions or findings. We are unable to predict the nature, extent or impact of any additional changes to statutes or regulations, including the interpretation, implementation or enforcement thereof, which may occur in the future.

The impact of the evolving regulatory environment on our business and operations depends upon a number of factors including final implementing regulations, guidance and interpretations of the regulatory agencies, supervisory priorities and actions, the actions of our competitors and other marketplace participants, and the behavior of consumers. The evolving regulatory environment could require us to limit or change our business practices, limit our product offerings, require continued investment of management time and resources in compliance efforts, limit fees we can charge for services, require us to meet more stringent capital, liquidity and leverage ratio requirements,

increase costs, impact the value of our assets, or otherwise adversely affect our businesses. The regulatory environment and enhanced examination and supervisory expectations and scrutiny can also potentially impact our ability to pursue business opportunities and obtain required regulatory approvals for potential investments and acquisitions.

Compliance and other regulatory requirements and expenditures have increased significantly for us and other financial services firms, and we expect them to continue to increase as regulators adopt new rules, interpret existing rules and increase their scrutiny of financial institutions, including controls and operational processes. We may face additional compliance and regulatory risk to the extent that we enter into new lines of business or new business arrangements with third-party service providers, alternative payment providers or other industry participants, including providers or participants that may not be regulated financial institutions. The additional expense, time and resources needed to comply with ongoing regulatory requirements may adversely impact our business and results of operations. In addition, regulatory findings and ratings could negatively impact our business strategies.

### ***We Are Affected by Governmental Monetary Policies***

Like all regulated financial institutions, we are affected by monetary policies implemented by the Federal Reserve and other federal instrumentalities. A primary instrument of monetary policy employed by the Federal Reserve is the restriction or expansion of the money supply through open market operations. This instrument of monetary policy frequently causes volatile fluctuations in interest rates, and it can have a direct, adverse effect on the operating results of financial institutions. Borrowings by the United States government to finance the government debt may also cause fluctuations in interest rates and have similar effects on the operating results of such institutions. See “BUSINESS—Supervision and Regulation.”

### ***The Impact of the Changing Regulatory Capital Requirements and Capital Rules Is Uncertain***

Under rules adopted by the Federal Reserve and FDIC, the leverage and risk-based capital ratios of bank holding companies may not be lower than the leverage and risk-based capital ratios for insured depository institutions. These rules became effective as to FFN and the Bank on January 1, 2015 and include new minimum risk-based capital and leverage ratios. Moreover, these rules refine the definition of what constitutes “capital” for purposes of calculating those ratios. The minimum capital level requirements now applicable to bank holding companies and banks subject to the rules are: (i) a Common Equity Tier 1 Capital ratio of 4.5%; (ii) a Tier 1 Risk-Based Capital ratio of 6%; (iii) a total Risk-Based Capital ratio of 8%; and (iv) a Tier 1 Leverage ratio of 4% for all institutions. The rules also establish a “capital conservation buffer” of 2.5% (being phased in over three years) above the new regulatory minimum capital ratios, and result in the following minimum ratios once the capital conservation buffer is fully phased in: (i) a Common Equity Tier 1 Risk-Based Capital ratio of 7.0%, (ii) a Tier 1 Risk-Based Capital ratio of 8.5%, and (iii) a total Risk-Based Capital ratio of 10.5%. The capital conservation buffer requirement began to be phased in beginning in January 2017 at 1.25% of risk-weighted assets and will increase each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases and paying discretionary bonuses if its capital levels fall below the buffer amounts. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

The application of these more stringent capital requirements to FFN and the Bank could, among other things, result in lower returns on invested capital, require the raising of additional capital, and result in regulatory actions if FFN or the Bank were to be unable to comply with such requirements. Furthermore, the imposition of liquidity requirements in connection with the implementation of the final rules could result in FFN or the Bank having to lengthen the term of their funding, restructure their business models and/or increase their holdings of liquid assets. Implementation of changes to asset risk weightings for risk-based capital calculations, items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could result in management modifying its business strategy and could limit FFN’s and the Bank’s ability to make distributions, including paying dividends or buying back shares. See “BUSINESS—Supervision and Regulation.”

### ***The Expanding Body of Federal, State and Local Regulation and/or the Licensing of Loan Servicing, Collections or Other Aspects of Our Business May Increase the Cost of Compliance And the Risks of Noncompliance***

We service our own loans, and loan servicing is subject to extensive regulation by federal, state and local governmental authorities as well as to various laws and judicial and administrative decisions imposing requirements and restrictions on those activities. The volume of new or modified laws and regulations has increased in recent years and, in addition, some individual municipalities have begun to enact laws that restrict loan servicing activities including delaying or temporarily preventing foreclosures or forcing the modification of certain mortgages. If regulators impose new or more restrictive requirements, we may incur additional significant costs to comply with such requirements which may further adversely affect us. In addition, our failure to comply with these laws and regulations could possibly lead to: civil and criminal liability; loss of licensure; damage to our reputation in the industry; fines and penalties and litigation, including class action lawsuits; and administrative enforcement actions. Any of these outcomes could materially and adversely affect our business, financial condition, results of operations and prospects.

### ***Federal and State Regulators Periodically Examine Our Business and We May Be Required to Remediate Adverse Examination Findings***

The Federal Reserve, the FDIC, and the TDFI periodically examine our business, including our compliance with laws and regulations. If, as a result of an examination, a banking agency were to determine that our financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of any of our operations had become unsatisfactory, or that we were in violation of any law or regulation, they may take a number of different remedial actions as they deem appropriate. These actions include the power to enjoin “unsafe or unsound” practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in our capital, to restrict our growth, to assess civil money penalties, to fine or remove officers and directors and, if it is concluded that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate our deposit insurance and place us into receivership or conservatorship. Any regulatory action against us could have an adverse effect on our business, financial condition and results of operations.

### ***We are Required to Comply with the Terms of a Memorandum of Understanding (“MOU”) that the Bank has Entered into with the Federal Reserve Bank of Atlanta (“Reserve Bank”) and the TDFI, and Lack of Compliance Could Result in Additional Regulatory Actions.***

On November 3, 2016, the Bank entered into an MOU with the Reserve Bank and the TDFI. Under the terms of the MOU, the Bank agreed, among other things, to enhance its policies, practices and processes to reflect the Bank’s increasingly complex business model and risk profile. The Bank has also agreed that it will seek prior written approval of the Reserve Bank and the TDFI to pay dividends to the Company, which dividends are used primarily for the purpose of servicing the Company’s subordinated debt.

The MOU will remain in effect until stayed, modified, terminated or suspended by the Reserve Bank and the TDFI. Management has been actively implementing plans and processes to comply with the requirements of the MOU. The Reserve Bank and the TDFI may determine in their sole discretion that the matters covered by the MOU have not been addressed satisfactorily, which could result in limitations on our business, including restricting growth and requiring increased capital, and negatively affect our ability to implement our business plan or the value of our common stock, as well as our financial condition, liquidity and results of operations.

### ***Our Growth May Be Limited by Regulatory Restrictions***

In addition to the MOU discussed above, the Company has executed an agreement with the Board of Governors of the Federal Reserve System under section 4(m)(2) of the Bank Holding Company Act (the “Agreement”), which includes specific actions designed to address the Bank’s risk profile and to strengthen the underlying condition of the Bank. Until FFN and the Bank satisfy the requirements of the MOU and the Agreement, any plans for business combinations, or location expansion will be limited and subject to prior written approval from the appropriate regulatory body. In the future, we may become subject to additional supervisory actions and/or enhanced regulation that could have a material negative effect on business, operating flexibility, financial condition, and the value of our common stock.

### ***Our FDIC Deposit Insurance Premiums and Assessments May Increase***

The deposits of our subsidiary bank are insured by the FDIC up to legal limits and, accordingly, subject our bank subsidiary to the payment of FDIC deposit insurance assessments. The Bank’s regular assessments are based on its average consolidated total assets minus average tangible equity as well as by risk classification, which includes regulatory capital levels and the level of supervisory concern. High levels of bank failures since the beginning of the financial crisis and increases in the statutory deposit insurance limits have increased resolution costs to the FDIC and put significant pressure on the DIF. In order to maintain a strong funding position and restore the reserve ratios of the DIF, the FDIC has, in the past, increased deposit insurance assessment rates and charged a special assessment to all FDIC-insured financial institutions. Further increases in assessment rates or special assessments may occur in the future, especially if there are significant additional financial institution failures. Any future special assessments, increases in assessment rates or required prepayments in FDIC insurance premiums could reduce our profitability or limit our ability to pursue certain business opportunities, which could have an adverse effect on our business, financial condition and results of operations.

### ***We Are Required to Act As a Source of Financial and Managerial Strength For Our Bank in Times of Stress***

Under federal law and longstanding Federal Reserve policy, we are expected to act as a source of financial and managerial strength to our bank, and to commit resources to support our bank if necessary. We may be required to commit additional resources to our bank at times when we may not be in a financial position to provide such resources or when it may not be in our, or our shareholders’ or creditors’, best interests to do so. Providing such support is more likely during times of financial stress for us and our

bank, which may make any capital we are required to raise to provide such support more expensive than it might otherwise be. In addition, any capital loans we make to our bank are subordinate in right of payment to depositors and to certain other indebtedness of our bank. In the event of our bankruptcy, any commitment by us to a federal banking regulator to maintain the capital of our bank will be assumed by the bankruptcy trustee and entitled to priority of payment. See “BUSINESS—Supervision and Regulation—Bank Holding Company Regulation.”

#### ***Future Acquisitions Generally Will Require Regulatory Approvals and Failure to Obtain Them Would Restrict Our Growth***

We may decide to explore complementing and expanding our products and services by pursuing strategic acquisitions. Generally, any acquisition of target financial institutions, branches or other banking assets by us will require approval by and cooperation from, a number of governmental regulatory agencies, possibly including the Federal Reserve, and the FDIC, as well as state banking regulators. In acting on applications, federal banking regulators consider, among other factors:

- The effect of the acquisition on competition;
- The financial condition, liquidity, results of operations, capital levels and future prospects of the applicant and the bank(s) involved;
- The quantity and complexity of previously consummated acquisitions;
- The managerial resources of the applicant and the bank(s) involved;
- The convenience and needs of the community, including the record of performance under the CRA;
- The effectiveness of the applicant in combating money-laundering activities;
- The applicant’s regulatory compliance record; and
- The extent to which the acquisition would result in greater or more concentrated risk to the stability of the United States banking or financial system.

Such regulators could deny our application based on the above criteria or other considerations, which would restrict our growth, or the regulatory approvals may not be granted on terms that are acceptable to us. For example, we could be required to sell branches as a condition to receiving regulatory approvals and such a condition may not be acceptable to us or may reduce the benefit of any acquisition.

#### ***We Face a Risk of Noncompliance and Enforcement Action with the Bank Secrecy Act and Other Anti-Money Laundering Statutes and Regulations***

The Bank Secrecy Act (the “BSA”), the USA PATRIOT Act of 2001 (the “Patriot Act”) and other laws and regulations require financial institutions, among other duties, to institute and maintain an effective anti-money laundering program and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. We are also subject to increased scrutiny of compliance with the rules enforced by the Office of Foreign Assets Control. If our policies, procedures and systems are deemed deficient, we would be subject to liability, including fines and regulatory actions, which may include restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us. Any of these results could have an adverse effect on our business, financial condition and results of operations.

#### ***We May Be Adversely Affected By Changes in U.S. Tax Laws and Regulations***

We are assessing the impact of the Tax Cuts and Jobs Act, enacted on December 22, 2017. This legislation required that we revalue our deferred tax items in the fourth quarter of 2017, based on the new corporate income tax rate. As we continue evaluating these items during 2018, subsequent adjustments could materially and adversely affect our results of operations. For additional information see Note 12, “Income Taxes,” in the Notes to Consolidated Financial Statements in Item 8, Financial Statements and Supplementary Data.

## **Risks Related to the Civic Merger**

### ***We Have Incurred and Will Incur Substantial Expenses Related to Our Pending Acquisition of Civic***

We have incurred and will incur substantial expenses in connection with our pending acquisition of Civic and integrating the operations of the acquired business of Civic with our operations. There are a number of factors beyond our control that could affect the total amount or the timing of our transaction and integration expenses and such expenses may exceed our initial projections. Many of the expenses that will be incurred, by their nature, are difficult to accurately estimate at the present time. As a result, the transaction and integration expenses associated with our pending acquisition of Civic could exceed the savings that we expect to achieve from the realization of economies of scale and cost savings related to the integration of the acquired business of Civic following the completion of the acquisition.

### ***Fluctuations in the Trading Price of FFN Common Stock Preceding the Effective Time of the Civic Merger Will Change the Number of Shares of FFN Common Stock That Civic Shareholders Will Receive in the Civic Merger.***

At the effective time of the Civic Merger, all outstanding shares of common stock of Civic will be exchanged for that number of shares of common stock of FFN with an aggregate value of \$28,625,000, calculated by dividing this aggregate value by the volume weighted average closing price of FFN's common stock for the 20 consecutive trading days ending on and including the 10th trading day preceding the effective date of the Civic Merger; provided, however, that the market value per share of FFN's common stock used to determine the number of shares of FFN common stock to be issued will be no more than \$29.50 per share, and no less than \$26.50 per share. Accordingly, the value of the shares of FFN common stock Civic shareholders will receive will not change, although the number of shares of common stock received will vary with the market price for FFN common stock, within the \$26.50 to \$29.50 range of market value, such that the number of shares of FFN common stock issued in the Civic Merger to holders of Civic common stock will be between 970,338 and 1,080,188 shares.

The market price of FFN's common stock at the time the Civic Merger is completed may vary from the price of FFN's common stock on the date the Merger Agreement was executed and/or on the date of the Civic special meeting as a result of various factors that are beyond the control of FFN and Civic, including but not limited to general market and economic conditions, changes in our respective businesses, operations and prospects, and regulatory considerations.

Before or after the Civic Merger, the market value of FFN common stock may decrease and be lower than the FFN market price that is used in calculating the consideration to be received by holders of Civic common stock in the Civic Merger.

### ***FFN May Not Be Able to Successfully Integrate Civic or to Realize the Anticipated Benefits of the Civic Merger***

The Civic Merger involves the combination of two banks that previously have operated independently. A successful combination of the operations of the two entities will depend substantially on FFN's ability to consolidate operations, systems and procedures and to eliminate redundancies and costs. FFN also intends to utilize most if not all of Civic's employees, a plan that may or may not be completely feasible as the growth of the banks and FFN continues and the demands of the marketplace dictate. FFN may not be able to combine the operations of Civic and FSB without encountering difficulties, such as:

- the loss of key employees;
- disruption of operations and business;
- inability to maintain and increase competitive presence;
- deposit attrition, customer loss and revenue loss;
- possible inconsistencies and disruptions during the period needed to integrate standards, control procedures and policies;
- unexpected problems with costs, operations, personnel, technology and credit; and/or
- problems with the assimilation of new operations, sites or personnel, which could divert resources from regular banking operations.

Additionally, general market and economic conditions or governmental actions affecting the financial industry generally may inhibit the successful integration of Civic and the Bank.

Further, FFN, the Bank and Civic entered into the Merger Agreement with the expectation that the Civic Merger will result in various benefits including, among other things, benefits relating to enhanced revenues, a strengthened market position for the combined company, cross-selling opportunities, technology, cost savings and operating efficiencies. Achieving the anticipated benefits of the Civic Merger is subject to a number of uncertainties, including whether FFN integrates Civic in an efficient and effective manner, and general competitive factors in the marketplace. Failure to achieve these anticipated benefits could result in increased costs, decreases in the amount of expected revenues and diversion of management's time and energy and could materially impact FFN's business, financial condition and operating results. Finally, any cost savings that are realized may be offset by losses in revenues or other charges to earnings.

### ***The Combined Company Will Incur Significant Transaction and Merger-Related Costs in Connection With the Merger***

FFN and Civic expect to incur costs associated with combining the operations of Civic and the Bank. FFN and Civic will need to collect additional information in order to formulate detailed integration plans to deliver planned synergies. Additional unanticipated costs may be incurred in the integration of the businesses of FFN and Civic. Although FFN and Civic expect that the elimination of duplicative costs, as well as the realization of other efficiencies related to the integration of the businesses, may offset incremental transaction and merger-related costs over time, this net benefit may not be achieved in the near term, or at all.

Whether or not the Civic Merger is consummated, FFN and Civic will incur substantial expenses, such as legal, accounting and financial advisory fees, in pursuing the Civic Merger.

### ***Directors and Officers of Civic have Potential Conflicts of Interest in the Merger***

You should be aware that some directors and officers of Civic have interests in the Civic Merger that are different from, or in addition to, the interests of Civic shareholders generally.

For example, certain of the executive officers of Civic have been offered change in control agreements by the Bank that provide the executive officer with payments upon a change in control of FFN or the Bank. Also, FFN has agreed to add Anil Patel, MD, to the boards of FFN and the Bank, and Dr. Patel will receive compensation for serving on these boards. These agreements may create potential conflicts of interest by creating vested interests in those persons in the completion of the Civic Merger. In addition, FFN agreed in the Merger Agreement to provide liability insurance to Civic officers and directors. These and certain other additional interests of Civic's directors and officers may cause some of these persons to view the proposed transaction differently than you view it, although Civic's board and officers currently have comparable director and officer insurance coverages.

### ***Failure to Complete the Civic Merger Could Cause FFN's Stock Price to Decline***

If the Civic Merger is not completed for any reason, FFN's stock price may decline because costs related to the Civic Merger, such as legal, accounting and financial advisory fees, must be paid even if the Civic Merger is not completed. In addition, if the Civic Merger is not completed, FFN's stock price may decline to the extent that the current market price reflects a market assumption that the Civic Merger will be completed or due to questions about why (or whose "fault" it was that) the Civic Merger was not completed.

## **Risks Related to an Investment in Our Common Stock**

### ***Shares of Our Common Stock Are Not Insured***

Shares of our common stock are not deposits and are not insured by the FDIC or any other entity and you will bear the risk of loss if the value or market price of our common stock is adversely affected.

### ***An Active, Liquid Market for Our Common Stock May Not Develop or Be Sustained, Which May Impair the Ability of Our Shareholders to Sell Their Shares***

We listed our common stock on the NYSE on March 26, 2015 under the symbol "FSB" in connection with our initial public offering. Even though our common stock is now listed, there is limited trading volume and an active, liquid trading market for our common stock may not develop or be sustained. A public trading market having the desired characteristics of depth, liquidity and orderliness depends upon the presence in the marketplace and independent decisions of willing buyers and sellers of our common stock, over which we have no control. If an active, liquid trading market for our common stock does not develop, shareholders may not be able to sell their shares at the volume, prices and times desired. Moreover, the lack of an established market could materially and adversely affect the value of our common stock. The market price of our common stock could decline significantly due to actual or anticipated issuances or sales of our common stock in the future.

### ***The Market Price of Our Common Stock May Fluctuate Significantly***

The market price of our common stock could fluctuate significantly due to a number of factors, including, but not limited to:

- our quarterly or annual earnings, or those of other companies in our industry;
- actual or anticipated fluctuations in our operating results, financial condition or asset quality;

- changes in economic or business conditions;
- the public reaction to our press releases, other public announcements or statements and our filings with the SEC;
- perceptions in the market place involving our competitors and/or us;
- changes in business, legal or regulatory conditions, or other developments affecting participants in our industry, and publicity regarding our business or any of our significant customers or competitors;
- changes in governmental monetary policies, including the policies of the Federal Reserve;
- regulatory actions that impact us, including actions taken by the Federal Reserve and the TDFI;
- changes in financial estimates and recommendations by securities analysts following our stock, or the failure of securities analysts to cover or continue to cover our common stock;
- changes in earnings estimates by securities analysts or our performance as compared to those estimates;
- significant acquisitions or business combinations, strategic partnerships, joint ventures, or capital commitments by or involving our competitors or us;
- the trading volume of our common stock;
- future sales of our common stock;
- our treatment as an “emerging growth company” under federal securities laws;
- additions or departures of key personnel;
- changes in accounting standards, policies, guidance, interpretations or principles;
- failure to integrate acquisitions or realize anticipated benefits from our acquisitions;
- rapidly changing technology; and
- other news, announcements or disclosures (whether by us or others) related to us, our competitors, our core market or the bank and non-bank financial services industries.

If any of the foregoing occurs, it could cause our stock price to fall and expose us to litigation that, even if our defense is successful, could distract management and be costly to defend.

#### ***Future Sales of Our Common Stock or Other Securities May Dilute the Value of Our Common Stock***

In many situations, our Board of Directors has the authority, without the approval of our shareholders, to issue shares of our authorized but unissued common stock or preferred stock, including shares authorized and unissued under our equity incentive plans. In the future, we may issue additional securities, through public or private offerings, in order to raise additional capital. Any such issuance would dilute the percentage of ownership interest of existing shareholders and may dilute the per share book value of the common stock. In addition, option holders under our stock-based incentive plans may exercise their stock options at a time when we would otherwise be able to obtain additional equity capital on more favorable terms.

#### ***The Rights of Our Common Shareholders Are Subordinate to the Rights of the Holders of Our Outstanding Subordinated Notes and Any Debt Securities That We May Issue in the Future and May Be Subordinate to the Holders of Any Class of Preferred Stock That We May Issue in the Future***

Shares of our common stock are equity interests and do not constitute indebtedness. As such, shares of our common stock rank junior to all of our outstanding indebtedness, including our outstanding March 2016 Notes and our June 2016 Notes, and to other non-equity claims against us and our assets available to satisfy claims against us, including in our liquidation. Additionally, our Board of Directors has the authority to issue in the aggregate up to 1,000,000 shares of preferred stock and to determine the terms of each issue of preferred stock without shareholder approval. Accordingly, you should assume that any shares of preferred stock that we may issue in the future will also be senior to our common stock and could have a preference on liquidating distributions or a preference on dividends that could limit our ability to pay dividends to the holders of our common stock. Upon our voluntary or involuntary dissolution, liquidation, or winding up of affairs, holders of shares of our common stock will not receive a distribution, if any, until after the payment in full of our debts and other liabilities, and the payment of any accrued but unpaid dividends and any liquidation preference on outstanding shares of preferred stock. Because our decision to issue debt or equity securities or incur other borrowings in the future will depend on market conditions and other factors beyond our control, the amount, timing, nature or success of our future capital-raising efforts is uncertain. Thus, common shareholders bear the risk that our future issuances of debt or equity securities or our incurrence of other borrowings will negatively affect the market price of our common stock.



### ***There Is No Certainty of Return on Investment***

No assurance can be given that a holder of shares of our common stock will realize a substantial return on his or her investment, or any return at all. Further, as a result of the uncertainty and risks associated with our operations as described in this “RISK FACTORS” section, it is possible that an investor will lose his or her entire investment.

### ***We Cannot Ensure When or If We Will Pay Dividends***

Our ability to pay dividends is highly dependent on the Bank’s ability to pay dividends and may be limited based upon regulatory restrictions and based upon our earnings and capital needs. The Bank is subject to various legal, regulatory and other restrictions on its ability to pay dividends and make other distributions and payments to us. On November 3, 2016, the Bank entered into an informal agreement with the Reserve Bank and the TDFI in the form of a MOU. Under the terms of the MOU, the Bank agreed, among other things, to seek prior written approval of the Reserve Bank and the TDFI to pay dividends to FFN, which dividends are used primarily for the purpose of servicing FFN’s subordinated debt. As a result, we cannot project or guarantee when dividends will be declared in the future, if at all. Our Board of Directors has also decided to not pay dividends on common stock at this time.

### ***We May Require Additional Capital***

The Board of Directors believes that the current level of capital will be adequate at the present time to sustain the operations and projected growth of FFN and the Bank and to enable FFN to service its debt. If FFN or the Bank fails to achieve sufficient financial performance (including as a result of significant provision expense as a result of deterioration in asset quality) or if the assets of the Bank grow more quickly than projected, management may determine, or government regulators may require, FFN or the Bank to raise additional capital. In the event FFN or the Bank falls below certain regulatory capital adequacy standards, they may become subject to regulatory intervention and restrictions. Although the Bank is currently “well capitalized,” under the terms of the MOU, the Bank agreed, among other things, to enhance its capital and liquidity plans. We can give no assurance that such additional capital is available at prices that will be acceptable to us, if at all. In the event of the issuance of additional shares, then current shareholders will not have the first right to subscribe to new shares (preemptive rights), so their ownership percentage may be diluted in the future. In addition, if FFN is not able to maintain sufficient capital at the holding company and the payment of dividends by the Bank to FFN is not approved by the Reserve Bank and the TDFI, it may be unable to service its debt.

### ***We Are an Emerging Growth Company and We Cannot Be Certain if the Reduced Disclosure Requirements Applicable to Emerging Growth Companies Will Make Our Common Stock Less Attractive to Investors***

We are an emerging growth company. For as long as we continue to be an emerging growth company, among other things, we may take advantage of certain exemptions from various reporting requirements that are applicable to public companies that are not emerging growth companies, including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and shareholder approval of any golden parachute payments not previously approved. In addition, even if we comply with the greater obligations of public companies that are not emerging growth companies, we may avail ourselves of the reduced requirements applicable to emerging growth companies from time to time in the future, so long as we are an emerging growth company. We will remain an emerging growth company for up to five years following the effectiveness of our Registration Statement on Form S-4, which was declared effective by the SEC on May 14, 2014, though we may cease to be an emerging growth company earlier under certain circumstances, including if, before the end of such five years, we are deemed to be a large accelerated filer under the rules of the SEC (which depends on, among other things, having a market value of common stock held by non-affiliates in excess of \$700 million) or if our total annual gross revenues equal or exceed \$1.07 billion in a fiscal year. We cannot predict if investors will find our common stock less attractive because we will rely on these exemptions. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock and our stock price may be more volatile.

### ***Anti-Takeover Provisions Could Adversely Affect Our Shareholders***

Tennessee law and provisions contained in our charter, as amended, and our amended and restated bylaws could make it difficult for a third party to acquire us, even if doing so might be beneficial to our shareholders. For example, our charter, as amended, authorizes our Board of Directors to determine the designation, preferences, limitations and relative rights of unissued preferred stock, without any vote or action by our shareholders. As a result, our Board of Directors could authorize and issue shares of preferred stock with voting or conversion rights that could adversely affect the voting or other rights of holders of our common stock or with other terms that could impede the completion of a merger, tender offer or other takeover attempt. In addition, certain provisions of Tennessee law, including a provision which restricts certain business combinations between a Tennessee corporation and certain interested shareholders, may delay, discourage or prevent an attempted acquisition or change in control of our company that some or all of our shareholders might consider to be desirable. As a result, efforts by our shareholders to change the direction or management of our company may be unsuccessful.

The ability of a third party to acquire us is also limited under applicable banking regulations. With certain limited exceptions, federal regulations prohibit a person, a company or a group of persons deemed to be “acting in concert” from, directly or indirectly, acquiring more than 10% (5% if the acquirer is a bank holding company) of any class of our voting stock or obtaining the ability to control in any manner the election of a majority of our directors or otherwise direct our management or policies without prior notice or application to and the approval of the Federal Reserve. Companies investing in banks and bank holding companies receive additional review and may be required to become bank holding companies, subject to regulatory supervision. Accordingly, prospective investors must be aware of and comply with these requirements, if applicable, in connection with any purchase of shares of our common stock. These provisions effectively inhibit certain mergers or other business combinations, which, in turn, could adversely affect the market price of our common stock.

**ITEM 1B. UNRESOLVED STAFF COMMENTS.**

None.

**ITEM 2. PROPERTIES.**

FFN’s and the Bank’s main office and headquarters operation is located at 722 Columbia Avenue, Franklin, Tennessee 37064. This location is leased by the Bank. The Bank operates branches at the following locations: 3359 Aspen Grove Drive, Suite 100, Franklin, Tennessee 37067; 134 Pewitt Drive, Suite 100, Brentwood, Tennessee 37027; 1015 Westhaven Blvd., Suite 150, Franklin, Tennessee 37064; 40 Moss Lane, Suite 100, Franklin, Tennessee 37064; 4824 Main Street, Suite A, Spring Hill, Tennessee 37174; 7177 Nolensville Road, Suite A3, Nolensville, Tennessee 37135; One East College Street, Murfreesboro, Tennessee 37130; 724 President Place, Smyrna, Tennessee 37167; 2415 Memorial Boulevard, Murfreesboro, Tennessee 37129; 2782 South Church Street, Murfreesboro, Tennessee 37127; 2610 Old Fort Parkway, Murfreesboro, Tennessee 37128; and 1605 Medical Center Parkway, Murfreesboro, Tennessee 37129. The Bank also operates a loan production office at 33 Music Square West, Nashville, Tennessee 37203. In addition, the Bank also has part of its operations in an office located at 101 Southeast Parkway, Suite 100, Franklin, TN 37064. Thirteen of these locations are leased by the Bank; two are owned. Certain lease agreements for these properties are with entities owned by related parties of FFN and the Bank.

**ITEM 3. LEGAL PROCEEDINGS.**

Neither we nor any subsidiary is aware of any pending or threatened material legal proceeding to which we or any such subsidiary is a party. Similarly, none of the properties of us or any subsidiary is subject to such proceedings.

**ITEM 4. MINE SAFETY DISCLOSURES.**

Not applicable.

## PART II

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

#### Market Information and Holders

Our common stock is traded on the New York Stock Exchange ("NYSE") under the ticker symbol "FSB". The following table sets forth the quarterly range of high and low market prices of our common stock as reported on the NYSE, as applicable, for the periods indicated since January 1, 2016.

	<u>High</u>	<u>Low</u>
<b>2017</b>		
First Quarter (January 1 to March 31)	\$42.60	\$35.75
Second Quarter (April 1 to June 30)	\$44.30	\$37.05
Third Quarter (July 1 to September 30)	\$42.15	\$30.30
Fourth Quarter (October 1 to December 31)	\$36.40	\$31.50
<b>2016</b>		
First Quarter (January 1 to March 31)	\$31.62	\$22.83
Second Quarter (April 1 to June 30)	\$33.53	\$24.80
Third Quarter (July 1 to September 30)	\$37.79	\$29.90
Fourth Quarter (October 1 to December 31)	\$42.80	\$29.85

As of February 28, 2018, we had 1,459 shareholders of record of our common stock.

#### Dividend Policy

We have not declared or paid any dividends on our common stock. We currently intend to retain all of our future earnings, if any, for use in our business and do not anticipate paying cash dividends on our common stock in the foreseeable future; however, our Board of Directors may decide to declare dividends in the future. Payments of future dividends, if any, will be at the discretion of our Board of Directors after taking into account various factors, including our business, operating results and financial condition, current and anticipated cash needs, plans for expansion, tax considerations, general economic conditions and any legal or contractual limitations on our ability to pay dividends. We are not obligated to pay dividends on our common stock.

As a bank holding company, our ability to pay dividends is affected by the policies and enforcement powers of the Federal Reserve. In addition, because we are a holding company, we are dependent upon the payment of dividends by the Bank to us as our principal source of funds to pay dividends in the future, if any, and to make other payments. The Bank is also subject to various legal, regulatory and other restrictions on its ability to pay dividends and make other distributions and payments to us. The Bank currently may not pay dividends without prior written approval from its primary regulatory agencies. See "BUSINESS—Supervision and Regulation." Under the terms of the MOU, the Bank agreed, among other things, to seek prior written approval of the Reserve Bank and the TDFI to pay dividends to FFN. In addition, in the future we may enter into borrowing or other contractual arrangements that restrict our ability to pay dividends.

#### Recent Sales of Unregistered Securities

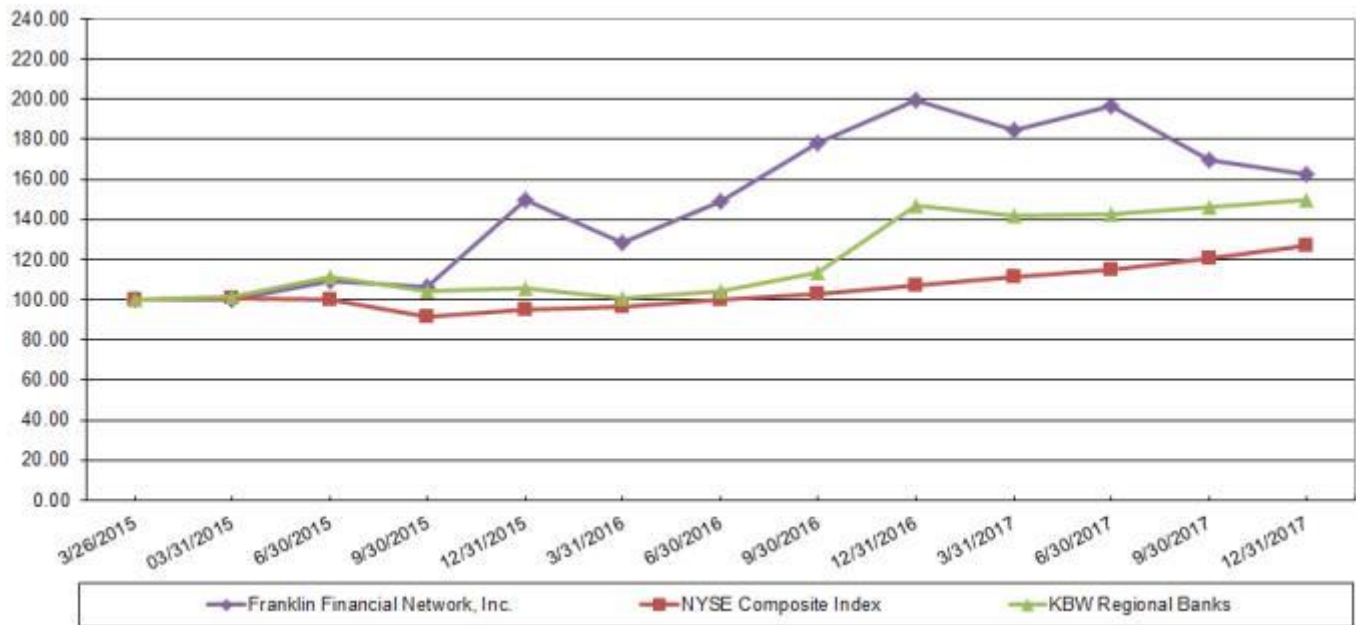
We had no unregistered sales of equity securities during the fourth quarter of 2017.

## Performance Graph

*This performance graph shall not be deemed “soliciting material” or to be “filed” with the SEC for purposes of Section 18 of the Exchange Act, or otherwise subject to the liabilities under that Section, and shall not be deemed to be incorporated by reference into any filing of Franklin Financial Network, Inc. under the Securities Act or the Exchange Act.*

The following graph shows a comparison from March 26, 2015 (the date our common stock commenced trading on the NYSE) through December 31, 2017 of the cumulative total return for our common stock, the NYSE Composite Index and the KBW Regional Banks Index. The graph assumes that \$100 was invested at the market close on March 26, 2015 in the common stock of Franklin Financial Network, Inc., the NYSE Composite Index and the KBW Regional Banks Index and data assumes reinvestments of dividends. The stock price performance of the following graph is not necessarily indicative of future stock price performance.

Comparison of 34 Month Cumulative Total Return  
Assumes Initial Investment of \$100  
December 2017



## ITEM 6. SELECTED HISTORICAL CONSOLIDATED FINANCIAL DATA.

The following selected historical consolidated financial data as of and for the years ended December 31, 2017, 2016, 2015, 2014 and 2013, is derived from the audited consolidated financial statements of FFN.

(Amounts are in thousands, except ratios, per share data, banking locations and full time equivalent employees.)

	Year ended December 31,				
	2017	2016	2015	2014	2013
<b>SUMMARY OF OPERATIONS:</b>					
Total interest income	\$ 132,453	\$ 99,907	\$ 68,721	\$ 43,432	\$ 24,982
Total interest expense	35,407	18,323	9,306	5,739	3,937
Net interest income	97,046	81,584	59,415	37,693	21,045
Provision for loan losses	4,313	5,240	5,030	2,374	907
Net interest income after provision for loan losses	92,733	76,344	54,385	35,319	20,138
Non-interest income	14,721	15,140	12,830	10,051	6,819
Non-interest expense	60,824	51,681	42,114	31,822	19,662
Income before income taxes	46,630	39,803	25,101	13,548	7,295
Income tax expense	18,531	11,746	9,021	5,134	2,734
Net income	28,099	28,057	16,080	8,414	4,561
Preferred stock dividend requirement	—	(23)	(100)	(100)	(109)
Earnings attributable to non controlling interest	(16)	—	—	—	—
Net income available to common shareholders	\$ 28,083	\$ 28,034	\$ 15,980	\$ 8,314	\$ 4,452
<b>PER COMMON SHARE DATA:</b>					
Basic earnings per share	\$ 2.14	\$ 2.56	\$ 1.62	\$ 1.32	\$ 1.13
Diluted earnings per share	\$ 2.04	\$ 2.42	\$ 1.54	\$ 1.27	\$ 1.10
Common equity per common share outstanding	\$ 23.01	\$ 20.73	\$ 16.92	\$ 14.41	\$ 11.34
Dividends per common share	\$ —	\$ —	\$ —	\$ —	\$ —
Preferred shares outstanding	—	—	10	10	10
Actual common shares outstanding	13,237	13,037	10,571	7,756	4,863
Weighted average common shares outstanding, including participating securities	13,145	10,933	9,885	6,320	3,934
Diluted weighted average common shares outstanding, including participating securities	13,780	11,608	10,390	6,557	4,038
<b>BALANCE SHEET DATA:</b>					
Assets	\$3,843,526	\$2,943,189	\$2,167,792	\$1,355,827	\$ 796,374
Loans held for sale	12,024	23,699	14,079	18,462	10,694
Loans, net of unearned income	2,256,608	1,773,592	1,303,826	787,188	421,304
Allowance for loan losses	21,247	16,553	11,587	6,680	4,900
Total securities	1,214,737	983,649	734,038	449,037	325,090
Total deposits	3,167,228	2,391,818	1,814,039	1,172,233	681,300
Federal Home Loan Bank advances	272,000	132,000	57,000	19,000	23,000
Other borrowed funds	89,519	141,638	101,086	39,078	24,291
Preferred shareholders' equity	—	—	10,000	10,000	10,000
Common shareholders' equity	304,550	270,258	178,816	111,799	55,163
Total shareholders' equity	304,550	270,258	188,816	121,799	65,163
Noncontrolling interest in consolidated subsidiary	103	103	—	—	—
Total equity	304,653	270,361	188,816	121,799	65,163
Average total assets	3,445,654	2,557,268	1,750,697	1,049,689	637,176
Average loans <sup>(1)</sup>	2,031,883	1,554,482	1,009,130	609,714	354,248
Average interest-earning assets	3,361,320	2,496,361	1,685,073	1,008,156	616,880
Average deposits	2,787,656	2,153,712	1,478,801	896,674	542,716
Average interest-bearing deposits	2,535,380	1,942,932	1,314,517	796,569	488,849
Average interest-bearing liabilities	2,891,943	2,125,986	1,409,753	848,993	525,906
Average total shareholders' equity	290,436	207,763	168,933	97,567	55,355

	Year ended December 31,				
	2017	2016	2015	2014	2013
<b>SELECTED FINANCIAL RATIOS:</b>					
Return on average assets	0.82%	1.10%	0.92%	0.80%	0.72%
Return on average equity	9.67%	13.50%	9.52%	8.62%	8.24%
Average equity to average total assets	8.43%	8.12%	9.65%	9.29%	8.69%
Dividend payout	— %	— %	— %	— %	— %
Efficiency ratio <sup>(2)</sup>	54.42%	53.43%	58.29%	66.65%	70.56%
Net interest margin <sup>(3)(5)</sup>	3.06%	3.42%	3.62%	3.74%	3.41%
Net interest spread <sup>(4)(5)</sup>	2.89%	3.29%	3.51%	3.63%	3.30%
<b>CAPITAL RATIOS:</b>					
Common equity Tier 1 ratio	11.37%	11.75%	10.08%	N/A	N/A
Tier 1 leverage ratio	8.25%	9.28%	8.48%	8.57%	9.78%
Tier 1 risk-based capital	11.37%	11.75%	10.51%	11.58%	13.83%
Total risk-based capital	14.40%	15.09%	11.21%	12.30%	14.81%
<b>ASSET QUALITY RATIOS:</b>					
Net charge-offs (recoveries) to average loans	(0.02)%	0.02%	0.01%	0.10%	0.00%
Allowance to period end loans <sup>(6)</sup>	0.94%	0.93%	0.89%	0.85%	1.16%
Allowance for loan losses to non-performing loans	698.45%	267.76%	352.62%	580.36%	188.39%
Non-performing assets to total assets	0.12%	0.21%	0.16%	0.14%	0.35%
<b>OTHER DATA:</b>					
Banking locations	13	12	11	11	4
Full-time equivalent employees	284	268	225	216	123

<sup>(1)</sup> Average loans include both loans held in the Bank's portfolio and mortgage loans held for sale and are net of deferred origination fees and costs.

<sup>(2)</sup> Efficiency ratio is non-interest expense divided by the sum of net interest income before the provision for loan losses plus non-interest income.

<sup>(3)</sup> Net interest margin is net interest income (annualized for interim periods) divided by total average earning assets.

<sup>(4)</sup> Net interest spread is the difference between the average yield on interest-earning assets and the average yield on interest-bearing liabilities.

<sup>(5)</sup> Interest income and rates for 2017, 2016 and 2015 include the effects of tax-equivalent adjustments, which adjust tax-exempt interest income on tax-exempt loans and investment securities to a fully taxable basis. Due to immateriality, interest income and rates for 2014 and prior exclude the effects of tax-equivalent adjustments.

<sup>(6)</sup> Period end loans exclude loans held for sale and exclude deferred fees and costs.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion and analysis identifies significant factors that have affected our financial position and operating results during the periods included in the accompanying financial statements. We encourage you to read this discussion and analysis in conjunction with Item 8 "FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA" as well as other information included in this Annual Report on Form 10-K. Unless otherwise noted, all amounts in this discussion are stated in thousands, with the exception of number of shares or per share amounts.

### Critical Accounting Policies

The accounting and reporting policies of the Company are in accordance with accounting principles generally accepted in the United States of America and conform to general practices within the banking industry. To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ.

The Company's accounting policies are integral to understanding the results reported. Accounting policies are described in detail in Note 1 of the notes to the consolidated financial statements included elsewhere in this report. The critical accounting policies require judgment to ascertain the valuation of assets, liabilities, commitments and contingencies. Management has established policies and control procedures that are intended to ensure valuation methods are well controlled and applied consistently from period to period. In addition, the policies and procedures are intended to ensure that the process for changing methodologies occurs in an appropriate manner. The following is a brief summary of the more significant policies:

#### *Allowance for Loan Losses*

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

All loans classified by management as substandard or worse are individually evaluated for potential designation as impaired. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component covers non-impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on a combination of the Bank's loss history and loss history from the Bank's peer group. This actual loss experience is supplemented with other economic factors based on the risks present for

each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations.

## Overview

The Company reported net income of \$28,099 for the year ended December 31, 2017, compared to \$28,057 for the year ended December 31, 2016, and \$16,080 for the year ended December 31, 2015. After earnings attributable to noncontrolling interest in 2017 and the payment of preferred dividends on the senior preferred stock issued to the Treasury pursuant to Small Business Lending Fund (“SBLF”) in 2016 and 2015, the Company’s net earnings available to common shareholders for the years ended December 31, 2017, 2016 and 2015 were \$28,083, \$28,034, and \$15,980, respectively. Net earnings available to shareholders increased by \$49 when comparing 2017 with 2016, primarily due to an increase of \$6,827 in income before taxes. That was offset by an increase of \$6,785 in income tax expense, of which \$5,323 is related to a deferred tax asset impairment that the Company recorded as an increase to income tax expense as a result of the Tax Cuts and Jobs Act of 2017 that was signed into law on December 22, 2017. The primary reason for the increase in net earnings available to common shareholders when comparing 2016 with 2015 was increased interest income on loans and investment securities due to significant organic growth in each of these portfolios during 2016.

## Net Interest Income/Margin

Net interest income consists of interest income generated by earning assets, less interest expense. Net interest income for the years ended December 31, 2017, 2016 and 2015 totaled \$97,046, \$81,584, and \$59,415, respectively, which are increases of \$15,462, or 19.0%, and \$22,169, or 37.3%, respectively.

For the years ended December 31, 2017 and 2016, interest income increased \$32,546 and \$31,186 due to growth in both the loan and investment securities portfolios. These were partially offset by increases of \$17,084 and \$9,017 in interest expense, which totaled \$35,407, \$18,323 and \$9,306, respectively, for the years ended December 31, 2017, 2016 and 2015, as a result of increases in interest-bearing deposits and borrowings. In addition, interest income and interest expense increased in 2017 due to Prime interest rate increases during the year on variable rate assets and liabilities.

Interest-earning assets averaged \$3,361,320, \$2,496,361, and \$1,685,073 during the years ended December 31, 2017, 2016 and 2015, which are increases of \$864,959, or 34.6%, and \$811,288, or 48.1%, respectively. The increases in 2017 and 2016 were primarily due to significant organic growth in loans and investment securities.

For the years ended December 31, 2017 and 2016, average loans increased 30.7% and 54.0%, respectively, and investment securities increased 38.9% and 38.9%, respectively. The yield on average interest-earning assets decreased four basis points to 4.11% during the year ended December 31, 2017, and decreased two basis points to 4.15% during the year ended December 31, 2016, compared to 4.17% for the year ended December 31, 2015. The yields on average loans decreased nine basis points during the year ended December 31, 2017 and 28 basis points during the year ended December 31, 2016. These decreases were due to the reduced accretion of discounts on purchased loans and due to lower interest rates and fees on loans added to the loan portfolio due to competitive pressures.

For the years ended December 31, 2017, 2016 and 2015, the yield on available for sale securities was 2.65%, 2.49% and 2.44%, respectively. The increase in yield in 2017 and 2016 is due to the increased volume of tax-exempt municipal securities that were purchased in 2017 and 2016 combined with the slowing of prepayment amortization during 2017.

For the years ended December 31, 2017, 2016 and 2015, the yield on held to maturity securities was 4.17%, 3.90% and 3.57%, respectively. The increase in yields in 2017 and in 2016 was attributable to the increased volume of tax-exempt municipal securities that have been purchased over the past two years, which increased the tax equivalent yield of the held to maturity portion of the securities portfolio, combined with the slowing of prepayment amortization.

Interest-bearing liabilities averaged \$2,891,943, \$2,125,986, and \$1,409,753, respectively, during the years ended December 31, 2017, 2016 and 2015, which are increases of \$765,957, or 36.0%, during 2017 and \$716,233, or 50.8%, during 2016. The increase for 2017 and 2016 was primarily due to growth of average interest-bearing deposits and growth in Federal Home Loan Bank advances.

During 2017, total average interest-bearing deposits grew \$592,448, which included increases in average interest checking of \$292,327, average money market accounts of \$10,104, and average time deposits outstanding of \$284,590. During 2016, total average interest-bearing deposits grew \$628,415, which included increases in average interest checking of \$63,540, average money market accounts of \$152,448, and average time deposits outstanding of \$398,681.



Growth in the loan portfolio also resulted in an increase in average Federal Home Loan Bank advances of \$159,803 and \$48,490, respectively in 2017 and 2016. Also, the Company's 2017 and 2016 average subordinated notes and other borrowings increased by \$19,145 and \$39,276, respectively, due to two subordinated note issuances during 2016.

The cost of average interest-bearing liabilities increased 36 basis points to 1.22% during 2017 and increased 20 basis points to 0.86% during 2016. The increase in 2017 cost of interest-bearing liabilities was due to increases in rates on interest checking, money market accounts, time deposits, Federal Home Loan Bank advances and Federal funds purchased. The increase in 2016 cost of interest-bearing liabilities was due to increases in rates on interest checking, money market accounts, Federal Home Loan Bank advances and the subordinated notes that were added during 2016.

The tables below summarize average balances, yields, cost of funds, and the analysis of changes in interest income and interest expense for the years ended December 31, 2017, 2016, and 2015:

Average Balances<sup>(7)</sup>—Yields & Rates  
(Dollars in thousands)

	Year Ended December 31,								
	2017			2016			2015		
	Average Balance	Interest Inc/Exp	Average Yield/Rate	Average Balance	Interest Inc/Exp	Average Yield/Rate	Average Balance	Interest Inc/Exp	Average Yield/Rate
<b>ASSETS:</b>									
<b>INTEREST-EARNING ASSETS</b>									
Loans <sup>(1)(6)</sup>	\$2,031,883	\$100,568	4.95%	\$1,554,482	\$ 78,329	5.04%	\$1,009,130	\$53,647	5.32%
Securities available for sale <sup>(6)</sup>	987,196	26,182	2.65%	666,745	16,593	2.49%	545,878	13,314	2.44%
Securities held to maturity <sup>(6)</sup>	222,222	9,267	4.17%	203,884	7,943	3.90%	80,932	2,887	3.57%
Restricted equity securities	16,498	928	5.62%	9,904	500	5.05%	6,940	350	5.04%
Certificates of deposit at other financial institutions	2,229	33	1.48%	827	15	1.81%	250	6	2.40%
Federal funds sold and other <sup>(2)</sup>	101,292	1,120	1.11%	60,519	241	0.40%	41,943	99	0.24%
<b>TOTAL INTEREST EARNING ASSETS</b>	<b>\$3,361,320</b>	<b>\$138,098</b>	<b>4.11%</b>	<b>\$2,496,361</b>	<b>\$103,621</b>	<b>4.15%</b>	<b>\$1,685,073</b>	<b>\$70,303</b>	<b>4.17%</b>
Allowance for loan losses	(18,729)			(13,923)			(8,398)		
All other assets	103,063			74,830			74,022		
<b>TOTAL ASSETS</b>	<b>\$3,445,654</b>			<b>\$2,557,268</b>			<b>\$1,750,697</b>		
<b>LIABILITIES &amp; EQUITY:</b>									
<b>INTEREST-BEARING LIABILITIES</b>									
<b>Deposits:</b>									
Interest checking	\$ 624,612	\$ 5,003	0.80%	\$ 332,285	\$ 1,411	0.42%	\$ 268,745	\$ 806	0.30%
Money market	627,140	6,542	1.04%	617,036	3,853	0.62%	464,588	2,616	0.56%
Savings	54,952	169	0.31%	49,525	162	0.33%	35,779	164	0.46%
Time deposits	1,228,676	15,750	1.28%	944,086	8,808	0.93%	545,405	5,102	0.94%
Federal funds purchased and other <sup>(3)</sup>	43,402	407	0.94%	48,841	303	0.62%	48,789	306	0.63%
Federal Home Loan Bank advances	254,740	3,215	1.26%	94,937	884	0.93%	46,447	312	0.67%
Subordinated notes and other borrowings	58,421	4,321	7.40%	39,276	2,902	7.39%	—	—	— %
<b>TOTAL INTEREST BEARING LIABILITIES</b>	<b>\$2,891,943</b>	<b>\$ 35,407</b>	<b>1.22%</b>	<b>\$2,125,986</b>	<b>\$ 18,323</b>	<b>0.86%</b>	<b>\$1,409,753</b>	<b>\$ 9,306</b>	<b>0.66%</b>
Demand deposits	252,276			210,780			164,284		
Other liabilities	10,999			12,739			7,727		
Total equity	290,436			207,763			168,933		
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$3,445,654</b>			<b>\$2,557,268</b>			<b>\$1,750,697</b>		
<b>NET INTEREST SPREAD<sup>(4)</sup></b>			<b>2.89%</b>			<b>3.29%</b>			<b>3.51%</b>
<b>NET INTEREST INCOME</b>		<b>\$102,691</b>			<b>\$ 85,298</b>			<b>\$60,997</b>	
<b>NET INTEREST MARGIN<sup>(5)</sup></b>			<b>3.06%</b>			<b>3.42%</b>			<b>3.62%</b>

(1) Loan balances include both loans held in the Bank's portfolio and mortgage loans held for sale and are net of deferred origination fees and costs. Non-accrual loans are included in total loan balances.

(2) Includes federal funds sold and interest-bearing deposits at the Federal Reserve Bank, the Federal Home Loan Bank and other financial institutions.

(3) Includes repurchase agreements.

(4) Represents the average rate earned on interest-earning assets minus the average rate paid on interest-bearing liabilities.

(5) Represents net interest income divided by total average earning assets.

(6) Interest income and rates include the effects of tax-equivalent adjustments to adjust tax-exempt interest income on tax-exempt loans and investment securities to a fully taxable basis.

(7) Average balances are average daily balances.

The tables below detail the components of the changes in net interest income for the periods indicated. For each major category of interest-earning assets and interest-bearing liabilities, information is provided with respect to changes due to average volume and changes due to rates, with the changes in both volumes and rates allocated to these two categories based on the proportionate absolute changes in each category. The changes noted in the table below include tax equivalent adjustments, and as a result, will not agree to the amounts reflected on the Company's consolidated statements of income for the categories that have been adjusted to reflect tax equivalent income.

#### Analysis of Changes in Interest Income and Expenses

	Net change year ended December 31, 2017 versus December 31, 2016			Net change year ended December 31, 2016 versus December 31, 2015		
	Volume	Rate	Net Change	Volume	Rate	Net Change
<b>INTEREST INCOME</b>						
Loans	\$24,068	\$ (1,829)	\$ 22,239	\$29,035	\$ (4,353)	\$ 24,682
Securities available for sale	8,009	1,580	9,589	2,946	333	3,279
Securities held to maturity	724	600	1,324	4,383	673	5,056
Restricted equity securities	334	94	428	149	1	150
Certificates of deposit at other financial institutions	25	(7)	18	14	(5)	9
Federal funds sold and other	160	719	879	45	97	142
<b>TOTAL INTEREST INCOME</b>	<b>\$33,320</b>	<b>\$ 1,157</b>	<b>\$ 34,477</b>	<b>\$36,572</b>	<b>\$ (3,254)</b>	<b>\$ 33,318</b>
<b>INTEREST EXPENSE</b>						
Deposits						
Interest checking	\$ 1,218	\$ 2,374	\$ 3,592	\$ 206	\$ 399	\$ 605
Money market accounts	55	2,634	2,689	867	370	1,237
Savings	18	(11)	7	62	(64)	(2)
Time deposits	2,642	4,300	6,942	3,800	(94)	3,706
Federal funds purchased and other	(35)	139	104	2	(5)	(3)
Federal Home Loan Bank advances	1,490	841	2,331	325	247	572
Subordinated notes and other borrowings	1,413	6	1,419	2,902	—	2,902
<b>TOTAL INTEREST EXPENSE</b>	<b>\$ 6,801</b>	<b>\$ 10,283</b>	<b>\$ 17,084</b>	<b>\$ 8,164</b>	<b>\$ 853</b>	<b>\$ 9,017</b>
<b>NET INTEREST INCOME</b>	<b>\$26,519</b>	<b>\$ (9,126)</b>	<b>\$ 17,393</b>	<b>\$28,408</b>	<b>\$ (4,107)</b>	<b>\$ 24,301</b>

#### Provision for Loan Losses

The provision for loan losses represents a charge to earnings necessary to establish an allowance for loan losses that, in management's evaluation, should be adequate to provide coverage for probable losses incurred in the loan portfolio. The allowance is increased by the provision for loan losses and is decreased by charge-offs, net of recoveries on prior loan charge-offs.

The provision for loan losses was \$4,313, \$5,240 and \$5,030 for the years ended December 31, 2017, 2016 and 2015, respectively. The decrease in provision amounts for 2017 compared to 2016 are due primarily to improvements in credit quality during 2017 compared to 2016. Nonperforming loans at December 31, 2017, 2016 and 2015 totaled \$3,042, \$6,182, and \$3,286, representing 0.1%, 0.3% and 0.3% of total loans, respectively.

## Non-Interest Income

Non-interest income for the years ended December 31, 2017, 2016 and 2015 was \$14,721, \$15,140 and \$12,856, respectively. The following is a summary of the components of non-interest income (in thousands):

	Years Ended December 31,		2017-2016 Percent Increase (Decrease)	Year Ended December 31,		2016-2015 Percent Increase (Decrease)
	2017	2016		2015		
Service charges on deposit accounts	\$ 154	\$ 185	(16.8%)	\$ 113		63.7%
Other service charges and fees	3,041	3,041	0.0%	2,644		15.0%
Net gains on sale of loans	6,779	7,183	(5.6%)	6,959		3.2%
Wealth management	2,577	1,894	36.1%	1,283		47.6%
Loan servicing fees, net	336	22	1,427.3%	227		(90.3%)
Gain on sales and calls of securities	896	2,172	(58.7%)	833		160.7%
Net (gain) loss on foreclosed assets	(7)	40	(117.5%)	26		53.8%
Other	945	603	56.7%	771		(21.8%)
Total non-interest income	<u>\$14,721</u>	<u>\$15,140</u>	<u>(2.8%)</u>	<u>\$ 12,856</u>		<u>17.8%</u>

Service charges on deposit accounts decreased 16.8% in 2017 compared to an increase of 63.7% in 2016. The decrease in service charges on deposit accounts in 2017 was attributed to the Bank's core system conversion in 2017, during which the Bank waived service charges for deposit accounts for two months as a courtesy to its customers. The increase in 2016 was due to changes made to the Company's schedule of service charges.

Other service charges and fees for the year ended December 31, 2017 remained steady from 2016. Other service charges and fees for the year ended December 31, 2016 increased 15.0% from 2015, due to increases in unused commitment fees, other loan-related fees and ATM surcharge income.

Net gains on the sale of loans include net gains realized from the sales of mortgage loans and SBA loans. Net gains on the sale of mortgage loans are based, in part, on differences between the carrying value of loans being sold to third-party investors and the selling price. Also included are changes in the fair value of mortgage banking derivatives entered into by the Company to hedge the change in interest rates on loan commitments prior to their sale in the secondary market. Fluctuations in mortgage interest rates, changes in the demand for certain loans by investors, and whether servicing rights associated with the loans being sold are retained or released all affect the net gains on mortgage loan sales. Net gains for the year ended December 31, 2017 were \$6,779, a decrease of \$404, or 5.6%, when compared to the year ended December 31, 2016. The decrease was primarily due to the Company recognizing \$4,802 in pricing adjustment gains during 2017, compared to \$6,742 during 2016, a decrease of \$1,939 or 28.8%. The decrease was offset by increases in mortgage discount fees and mortgage hedging income recognized during 2017 of \$697 and \$803, respectively. Net gains for the year ended December 31, 2016 were \$7,183, an increase of \$224, or 3.2%, from the year ended December 31, 2015, primarily attributed to the volume of mortgage loans sold during 2016.

Wealth management income is the commission earned based on the investment brokerage activities and volume related to the Company's wealth management clients. These commissions are also impacted by market conditions and will fluctuate from time to time due to rises and declines in the investment markets. Wealth management income for 2017 was \$2,577, an increase of 36.1% when compared with 2016. Wealth management income for 2016 was \$1,894, an increase of 47.6% when compared with 2015. The increases in wealth management income for 2017 and 2016 are attributable to the growth in assets under management and the growth in the investment markets during 2017 and 2016.

Loan servicing fees are fees earned for servicing residential mortgages and SBA loans offset by the amortization of the related servicing rights. These servicing rights are initially recorded at fair value and then amortized in proportion to, and over the period of, the estimated life of the underlying loans. In addition, impairment to the mortgage servicing rights may be recognized through a valuation allowance, and adjustments to the allowance can affect the net loan servicing fees. For the year ended December 31, 2017, net loan servicing fees were \$336 compared to \$22 for the year ended December 31, 2016. The increase in servicing fees for 2017 is attributable to a decrease in amortization for 2017 compared to 2016. For the year ended December 31, 2016, net loan servicing fees were \$22 compared to \$227 for the year ended December 31, 2015. The decrease in servicing fees in 2016 is attributable to the increase in amortization during 2016.

Gains on sales and calls of securities for the year ended December 31, 2017 amounted to \$896, a decrease of \$1,276, or 58.7%, when compared with the same period in 2016. The decrease for 2017 is attributed to the Company selling less securities in a gain

position due to rising rates. For the year ended December 31, 2016, gains on sales and calls of securities increased \$1,339, or 160.7%, when compared with the year ended December 31, 2015. The increases for 2016 are attributed to the repositioning of the Company's investment portfolio over the past two years, during which time management has increased investments in tax-exempt municipal securities in a strategic initiative related to the Company's tax position.

Other non-interest income increased \$342, or 56.7%, when comparing the years ended December 31, 2017 and 2016, and it decreased \$168, or 21.8%, when comparing the years ended December 31, 2016 and 2015. The increase in other non-interest income for 2017 is primarily attributable to no losses on the sale of assets held for sale compared to the \$98 loss realized in 2016 and also to an increase of \$169 related to bank-owned life insurance income. The decrease in other non-interest income for 2016 is attributable to the \$98 loss on the sale of two properties of the Bank on College Street in downtown Murfreesboro, Tennessee, and to the reduction of investment services income due to the Company no longer offering that service to other banks.

### Non-interest Expense

Non-interest expense for the years ended December 31, 2017, 2016 and 2015 was \$60,824, \$51,681 and \$42,140, respectively. This increase was the result of the following components listed in the table below (in thousands):

	Years Ended December 31,		2017-2016 Percent Increase (Decrease)	Year Ended December 31, 2015	2016-2015 Percent Increase (Decrease)
	2017	2016			
Salaries and employee benefits	\$35,268	\$30,029	17.4%	\$ 24,040	24.9%
Occupancy and equipment	9,219	7,627	20.9%	6,589	15.8%
FDIC assessment expense	3,680	2,068	77.9%	1,167	77.2%
Marketing	965	762	26.6%	956	(20.3%)
Professional fees	3,395	3,546	(4.3%)	2,425	46.2%
Other	8,297	7,649	8.5%	6,963	9.9%
Total non-interest expense	<u>\$60,824</u>	<u>\$51,681</u>	<u>17.7%</u>	<u>\$ 42,140</u>	<u>22.6%</u>

The increase in non-interest expense noted in the table above is relative to the Company's overall current growth. One of the major increases was in salaries and employee benefits. When comparing 2017, 2016 and 2015, salaries and employee benefits increased as a result of the increasing the Company's full-time equivalent employees from 225 as of December 31, 2015 to 268 as of December 31, 2016, and then to 284 as of December 31, 2017. The increase in 2017 is attributable to the Company's building infrastructure to support the Company's growth and to support the Company's ongoing compliance initiatives.

During 2017 and 2016, salaries and employee benefits expense increased 17.4% and 24.9%, respectively, with increases in salary expense and stock option expense being the largest attributes of the increase in 2017. The largest attributes of the increase in 2016 were increases in salary expense and mortgage commissions. Salary expense increased in 2017 and 2016 due to the addition of a variety of personnel, i.e., experienced lenders, compliance and operational personnel, etc. Mortgage commissions increased in 2016 due to increased volume of mortgage loans originated during that year.

The increase in occupancy and equipment expense during 2017 is attributable to the addition of new branch locations in Murfreesboro, Tennessee, and Spring Hill, Tennessee, which attributed to rent expense increasing \$852. Additionally, the growth is related to an increase of \$420 for software maintenance fees. The increase in occupancy and equipment expense during 2016 is attributable to the addition of a new branch location in Nolensville, Tennessee, the addition of the loan production office in Nashville, Tennessee and the addition of the mortgage loan operations facility on the campus of the Company's headquarters in Franklin, Tennessee; and increased depreciation expenses related to the furniture, equipment and leasehold improvements that have been added as a result of the Company's facilities growth.

The Company's FDIC assessment increased in 2017 and 2016 due to the Company's growth in assets during the year, coupled with the assessment calculation model instituted by the FDIC during 2016 which, due to the Company's above average asset growth, loan mix and its level of brokered deposits, increased the Company's FDIC assessment expenses beginning in the third quarter of 2016.

The increase in marketing expenses during 2017 is attributed to increased marketing and public relations efforts to further the growth of the Company. The decrease in marketing expenses during 2016 is attributed to the Company's scaling back of some of its marketing initiatives while assessing the benefits and uses for various media sources.

The 4.3% decrease in professional fees during 2017 is related to decreases in several types of expenses, as follows: other professional fees (\$294) regulatory compliance expense (\$84), merger expenses (\$272). These decreases were offset by increases in several types of expense, as follows: brokerage settlement expenses (\$156), audit and accounting fees (\$215) and legal fees (\$124). The following types of expenses are included in other professional fees: consulting engagements that include design and implementation of subsidiary companies and lending process optimization initiatives, asset/liability management services, human resources services, talent recruitment services, information technology security, trust operations outsourcing, and corporate communications. The 46.2% increase in professional fees during 2016 is related to increases in several types of expenses, as follows: other professional fees (\$703) regulatory compliance expense (\$211), merger expenses (\$188), and brokerage settlement expenses (\$137).

Other noninterest expense increased \$648, or 8.5%, during 2017 and \$686, or 9.9%, during 2016 due to a number of different types of expenses. During 2017, the larger increases included the following: loan servicing expense (\$232); bond insurance (\$112); public company fees (\$33). During 2016, the larger increases included the following: insurance expense (\$256); franchise taxes (\$194); regulatory compliance expense (\$119); electronic banking expense (\$118); and ATM-related expenses (\$112). These were offset by a decrease in deposit account losses of \$124.

### Income Tax Expense

The Company recognized an income tax expense for the years ended December 31, 2017, 2016, and 2015 of \$18,531, \$11,746, and \$9,021, respectively. The Company's year-to-date income tax expense for the years ended December 31, 2017, 2016, and 2015 reflects effective income tax rates 39.7%, 29.5%, and 35.9%, respectively. The increase in the effective tax rate for 2017 is attributed to a non-recurring charge of \$5,323 related to a write-down of its deferred tax asset (the "DTA write-down") as a result of the reduction in the federal income tax rate to 21% from 35% under the Tax Cuts and Jobs Act (the "Tax Act"), which was signed into law on December 22, 2017. Had the Tax Act not become law in 2017, the Company's income tax expense would have been \$13,208, which would have resulted in an effective tax rate of 28.3% for 2017. The decrease in the effective tax rate for 2016 is attributed to adoption of Accounting Standard Update 2016-09, which decreased the Company's income tax expense for 2016 by just over \$1 million. In addition, the increase in the Company's tax-exempt investment securities played a part in decreasing the Company's effective tax rate for 2016.

### Return on Equity and Assets

The following schedule details selected key ratios for the years ended December 31, 2017, 2016 and 2015:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Return on assets (net income divided by average total assets)	0.82%	1.10%	0.92%
Return on equity (Net income divided by average equity)	9.67%	13.50%	9.52%
Dividend payout ratio (Dividends declared per share divided by net income per share)	— %	— %	— %
Equity to asset ratio (Average equity divided by average total assets)	8.43%	8.12%	9.65%
Leverage capital ratio (Equity divided by fourth quarter average total assets, excluding accumulated other comprehensive income)	8.25%	9.28%	8.48%

The minimum leverage capital ratio required by the regulatory agencies is 4.00%.

Under guidelines developed by regulatory agencies a “risk weight” is assigned to various categories of assets and commitments ranging from 0% to 300% based on the risk associated with the asset. The following schedule details the Bank’s risk-based capital at December 31, 2017 excluding the net unrealized gain on available-for-sale securities which is shown as an addition in stockholders’ equity in the consolidated financial statements:

	<u>In Thousands, Except Percentages</u>
Common Equity Tier 1 capital:	
Stockholders’ equity, excluding accumulated other comprehensive income, disallowed goodwill, other disallowed intangible assets and disallowed servicing assets	\$ 299,229
Tier 1 capital:	
Common Equity Tier 1 capital plus additional tier 1 capital instruments and related surplus, less additional tier 1 capital deductions	\$ 299,229
Tier 2 capital:	
Tier 2 capital instruments plus related surplus	58,515
Total capital minority interest that is not included in tier 1 capital	92
Allowable allowance for loan losses (limited to 1.25% of gross risk-weighted assets)	21,247
Total risk-based capital	<u>\$ 379,083</u>
Risk-weighted assets, gross	\$ 2,632,854
Less: Excess allowance for loan and lease losses	—
Risk-weighted assets, net	<u>\$ 2,632,854</u>
Risk-based capital ratios:	
Common Equity Tier 1 risk-based capital ratio	<u>11.37%</u>
Tier 1 risk-based capital ratio	<u>11.37%</u>
Total risk-based capital ratio	<u>14.40%</u>

The minimum Common Equity Tier 1 risk-based capital ratio required by the regulatory agencies is 4.50%. Tier 1 risk-based capital ratio required by the regulatory agencies is 6.00%, and the minimum total risk-based capital ratio required is 8.00%. At December 31, 2017, the Company was in compliance with these requirements.

## COMPARISON OF BALANCE SHEETS AT DECEMBER 31, 2017 AND DECEMBER 31, 2016

### Overview

The Company’s total assets increased by \$900,337, or 30.6%, from December 31, 2016 to December 31, 2017. The increase in total assets was funded by the Company’s growth in deposits and Federal Home Loan Bank advances, which allowed for organic growth in both the loan portfolio and the investment portfolio.

The following table presents the growth experienced by the Company when comparing selected balance sheet totals from December 31, 2017 and 2016:

<u>In Thousands</u>	<u>Dec 31, 2017</u>	<u>Dec 31, 2016</u>	<u>Growth</u>	<u>Growth Percentage</u>
Total Loans	\$2,256,608	\$1,773,592	\$483,016	27.2%
Total Securities	1,214,737	983,649	231,088	23.5%
Total Assets	3,843,526	2,943,189	900,337	30.6%
Total Deposits	3,167,228	2,391,818	775,410	32.4%
Total Liabilities	3,538,873	2,672,828	866,045	32.4%
Total Equity	304,653	270,361	34,292	12.7%

### Loans Held For Sale

At December 31, 2017, the Company had \$12,024 in mortgage loans held for sale, compared to \$23,699 as of December 31, 2016, a decrease of 49.3%. The decrease is attributable to the volume of loans closed and in the process of being sold to investors at December 31, 2017 as compared to December 31, 2016. For the years ended December 31, 2017, 2016 and 2015, the Company recorded gains from sales of mortgage loans totaling \$6,779, \$7,183, and \$6,959, respectively.

### Loans

Lending-related income is the most important component of the Company's net interest income and is a major contributor to profitability. The loan portfolio is the largest component of earning assets, and it therefore generates the largest portion of revenues. The absolute volume of loans and the volume of loans as a percentage of earning assets is an important determinant of net interest margin as loans are expected to produce higher yields than securities and other earning assets. Total loans, net of deferred fees, at December 31, 2017 and 2016 were \$2,256,608 and \$1,773,592, respectively, an increase of \$483,016, or 27.2%. This growth in the loan portfolio is due to increased market penetration and a healthy local economy, as well as the addition of several experienced lending officers.

The table below provides a summary of the loan portfolio composition for the periods noted.

Types of Loans	As of December 31,				
	2017	2016	2015	2014	2013
Total loans, excluding PCI loans					
Real estate:					
Construction and land development	\$ 494,818	\$ 489,562	\$ 372,767	\$ 239,225	\$ 113,710
Commercial	678,238	497,140	364,223	246,352	125,202
Residential	577,335	404,989	274,934	213,760	138,466
Commercial and industrial	502,006	376,476	283,888	76,570	36,397
Consumer and other	3,781	3,359	6,577	8,025	8,250
Total loans—gross, excluding PCI loans	<u>2,256,178</u>	<u>1,771,526</u>	<u>1,302,389</u>	<u>783,932</u>	<u>422,025</u>
Total PCI loans <sup>(1)</sup>	<u>2,393</u>	<u>2,859</u>	<u>3,913</u>	<u>4,315</u>	<u>—</u>
Total gross loans	2,258,571	1,774,385	1,306,302	788,247	422,025
Less: deferred loan fees, net	(1,963)	(793)	(2,476)	(1,059)	(721)
Allowance for loan losses	(21,247)	(16,553)	(11,587)	(6,680)	(4,900)
Total loans, net allowance for loan losses	<u>\$2,235,361</u>	<u>\$1,757,039</u>	<u>\$1,292,239</u>	<u>\$ 780,508</u>	<u>\$ 416,404</u>

<sup>(1)</sup> PCI accounted for pursuant to ASC Topic 310-30.

As presented in the above table, gross loans increased \$484,186, or 27.3%, during 2017. During 2017, the Company experienced growth in real estate loans of 25.7%, with the growth occurring in the construction and land development (1.1%), commercial real estate (36.4%) and residential real estate (42.4%) segments. The Company also experienced solid growth of 33.2% in the commercial and industrial segment during 2017.

Real estate loans comprised 77.5% of the loan portfolio at December 31, 2017. The largest portion of the real estate segments of the portfolio as of December 31, 2017, was commercial real estate loans, which totaled \$678,618 at December 31, 2017, comprising 38.8% of real estate loans and 30.0% of the total loan portfolio. The commercial real estate loan classification primarily includes commercial-based mortgage loans that are secured by nonfarm, nonresidential real estate properties and multi-family residential properties.

Construction and land development loans totaled, \$494,818, or 28.3%, of real estate loans and comprised 21.9% of the total loan portfolio at December 31, 2017. Loans in this classification provide financing for the construction and development of residential properties and commercial income properties, multi-family residential development, and land designated for future development.

The residential real estate classification primarily includes 1-4 family residential loans which are typically conventional first-lien home mortgages or junior lien mortgages, not including loans held-for-sale in the secondary market. Residential real estate loans totaled \$577,440 and comprised 33.0% of real estate loans and 25.6% of total loans at December 31, 2017.



Commercial and industrial loans consist of commercial loans, including healthcare loans, to various sizes of businesses that are primarily secured by commercial assets, such as inventories, business equipment, receivables and other commercial assets. At December 31, 2017, commercial and industrial loans made up 22.3% of the total loan portfolio, and healthcare loans comprised 49.9% of the Company's commercial and industrial loans at December 31, 2017.

The repayment of loans is a source of additional liquidity for the Company. The following table sets forth the loans maturing within specific intervals at December 31, 2017, excluding unearned net fees and costs.

#### Loan Maturity Schedule

	December 31, 2017			Total
	One year or less	Over one year to five years	Over five years	
Real estate:				
Construction and land development	\$288,222	\$ 156,877	\$ 49,719	\$ 494,818
Commercial	47,422	159,729	471,467	678,618
Residential	35,324	115,742	426,374	577,440
Commercial and industrial	88,386	337,309	78,219	503,914
Consumer and other	2,173	1,190	418	3,781
Total	<u>\$461,527</u>	<u>\$ 770,847</u>	<u>\$1,026,197</u>	<u>\$2,258,571</u>
Fixed interest rate	\$203,609	\$ 309,842	\$ 504,407	\$1,017,858
Variable interest rate	257,918	461,005	521,790	1,240,713
Total	<u>\$461,527</u>	<u>\$ 770,847</u>	<u>\$1,026,197</u>	<u>\$2,258,571</u>

The information presented in the above table is based upon the contractual maturities of the individual loans, including loans which may be subject to renewal at their contractual maturity. Renewal of such loans is subject to review and credit approval, as well as modification of terms upon their maturity. Consequently, management believes this treatment presents fairly the maturity structure of the loan portfolio.

#### *Allowance for Loan Losses*

The Company maintains an allowance for loan losses that management believes is adequate to absorb the probable incurred losses in the Company's loan portfolio. The allowance is increased by provisions for loan losses charged to earnings and is decreased by loan charge-offs net of recoveries of prior period loan charge-offs. The level of the allowance is determined on a quarterly basis, although management is engaged in monitoring the adequacy of the allowance on a more frequent basis. In estimating the allowance balance, the following factors are considered:

- past loan experience;
- the nature and volume of the portfolio;
- risks known about specific borrowers;
- underlying estimated values of collateral securing loans;
- current and anticipated economic conditions; and
- other factors which may affect the allowance for probable incurred losses.

The allowance for loan losses consists of two primary components: (1) a specific component which relates to loans that are individually classified as impaired and (2) a general component which covers non-impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on a combination of the Company's loss history and loss history from a peer group. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment.

The following loan portfolio segments have been identified: (1) Construction and land development loans, (2) Commercial real estate loans, (3) Residential real estate, (4) Commercial and industrial loans, and (5) Consumer and other loans. Management evaluates the risks associated with these segments based upon specific characteristics associated with the loan segments. These risk characteristics include, but are not limited to, the value of the underlying collateral, adverse economic conditions, and the borrower's cash flow. While the total allowance consists of a specific portion and a general portion, both portions of the allowance are available to provide for probable incurred loan losses in the entire portfolio.

In the table below, the components, as discussed above, of the allowance for loan losses are shown at December 31, 2017 and 2016.

	December 31, 2017			December 31, 2016			Increase (Decrease)		
	Loan Balance	ALLL Balance	%	Loan Balance	ALLL Balance	%	Loan Balance	ALLL Balance	
Non impaired loans	\$2,201,515	\$20,358	0.92%	\$1,687,244	\$15,506	0.92%	\$514,271	\$4,852	—
Non-PCI acquired loans <sup>(1)</sup>	50,522	10	0.02%	74,373	23	0.03%	(23,851)	(13)	-1bps
Impaired loans	4,141	879	21.23%	9,909	1,024	10.33%	(5,768)	(145)	1,090bps
Non-PCI loans	2,256,178	21,247	0.94%	1,771,526	16,553	0.93%	484,652	4,694	1 bps
PCI loans	2,393	—	— %	2,859	—	— %	(466)	—	—
Total loans	<u>\$2,258,571</u>	<u>\$21,247</u>	<u>0.94%</u>	<u>\$1,774,385</u>	<u>\$16,553</u>	<u>0.93%</u>	<u>\$484,186</u>	<u>\$4,694</u>	<u>1bps</u>

<sup>(1)</sup> Loans acquired pursuant to the July 1, 2014 acquisition of MidSouth that are not PCI loans. These are performing loans recorded at estimated fair value at the acquisition date. This fair value discount established at acquisition is accreted into interest income over the remaining lives of the related loans on a level yield basis. The remaining fair value discount balance at December 31, 2017 related to the non-PCI acquired loans was \$1,426, or 2.7% of the outstanding aggregate loan balances. At December 31, 2017, one of the non-PCI loans was identified as impaired beyond the extent of its recorded discount, and an allowance for loan loss of \$10 was recorded related to the acquired loans.

At December 31, 2017, the allowance for loan losses was \$21,247, compared to \$16,553 at December 31, 2016. The allowance for loan losses as a percentage of total loans was 0.94% and 0.93% at December 31, 2017 and 2016, respectively. Loan growth during the period is the primary reason for the increase in the allowance for loan losses.

The table below sets forth the activity in the allowance for loan losses for the years presented.

	2017	2016	2015	2014	2013
Beginning balance	\$ 16,553	\$ 11,587	\$ 6,680	\$ 4,900	\$ 3,983
Loans charged-off:					
Construction & land development	—	(11)	—	—	—
Commercial real estate	—	—	—	(540)	—
Residential real estate	(1)	(40)	(32)	(61)	(107)
Commercial & industrial	(310)	(255)	(48)	(58)	(19)
Consumer	(49)	(42)	(135)	—	—
Total loans charged-off	(360)	(348)	(215)	(659)	(126)
Recoveries on loans previously charged-off:					
Construction & land development	668	—	—	—	—
Commercial real estate	—	—	—	—	—
Residential real estate	50	66	26	65	136
Commercial & industrial	6	1	1	—	—
Consumer	17	7	65	—	—
Total loan recoveries	741	74	92	65	136
Net recoveries (charge-offs)	381	(274)	(123)	(594)	10
Provision for loan losses charged to expense	4,313	5,240	5,030	2,374	907
Total allowance at end of period	<u>\$ 21,247</u>	<u>\$ 16,553</u>	<u>\$ 11,587</u>	<u>\$ 6,680</u>	<u>\$ 4,900</u>
Total loans, gross, at end of period <sup>(1)</sup>	<u>\$2,258,571</u>	<u>\$1,774,385</u>	<u>\$1,306,302</u>	<u>\$788,247</u>	<u>\$422,025</u>
Average gross loans <sup>(1)</sup>	<u>\$2,022,052</u>	<u>\$1,574,387</u>	<u>\$ 997,873</u>	<u>\$594,974</u>	<u>\$343,697</u>
Allowance to total loans	<u>0.94%</u>	<u>0.93%</u>	<u>0.89%</u>	<u>0.85%</u>	<u>1.16%</u>
Net charge-offs (recoveries) to average loans	<u>(0.02)%</u>	<u>0.02%</u>	<u>0.01%</u>	<u>0.10%</u>	<u>0.00%</u>

<sup>(1)</sup> Loan balances exclude loans held for sale

While no portion of the allowance is in any way restricted to any individual loan or group of loans, and the entire allowance is available to absorb losses from any and all loans, the following table summarizes the allocation of allowance for loan losses by loan category and loans in each category as a percentage of total loans, for the periods presented.

	2017		2016		2015		2014		2013	
	Amount	% of Loan Type to Total Loans	Amount	% of Loan Type to Total Loans	Amount	% of Loan Type to Total Loans	Amount	% of Loan Type to Total Loans	Amount	% of Loan Type to Total Loans
Real estate loans:										
Construction and land development	\$ 3,802	21.9%	\$ 3,776	27.6%	\$ 3,186	28.5%	\$ 2,690	30.4%	\$ 1,552	26.9%
Commercial	5,981	30.0%	4,266	28.0%	3,146	28.0%	1,494	31.5%	1,511	29.7%
Residential	3,834	25.6%	2,398	22.9%	1,861	21.1%	1,791	27.2%	1,402	32.8%
Total real estate	13,617	77.5%	10,440	78.5%	8,193	77.6%	5,975	89.1%	4,465	89.4%
Commercial and industrial	7,587	22.3%	6,068	21.3%	3,358	21.9%	650	9.9%	337	8.6%
Consumer and other	43	0.2%	45	0.2%	36	0.5%	55	1.0%	98	2.0%
	<u>\$21,247</u>	<u>100.0%</u>	<u>\$16,553</u>	<u>100.0%</u>	<u>\$11,587</u>	<u>100.0%</u>	<u>\$ 6,680</u>	<u>100.0%</u>	<u>\$ 4,900</u>	<u>100.0%</u>

Fluctuations in the allocations during the periods presented are due, in part, to changes in the specific reserve factors assigned to each category of loans. The Corporation has relied heavily on the loss history of peer groups due to the lack of its own history of losses; therefore, reserve factors have been adjusted in accordance with the loss performance experienced by a select group of local peer banks. Allocations between categories of loans have also been affected by the change in the mix of loans among the categories.

As of December 31, 2017, the largest component of the allowance for loan losses was associated with commercial and industrial loans, followed by commercial real estate loans and construction and land development loans. The increase on these reserves as a percentage of the total allowance in these categories was primarily due to significant loan growth in these portfolio segments and, in the commercial and industrial loans, the specific allowance related to impaired loans. Commercial and industrial loans grew 33.2% from \$378,445, or 21.3% of total loans at the end of 2016, to \$503,914, or 22.3% of total loans at year-end 2017. During 2017, construction and land development loans increased from \$489,562 at December 31, 2016 to \$494,818 at December 31, 2017, an increase of 1.1%. During the same period, commercial real estate loans increased 36.4%, from \$497,534 at December 31, 2016 to \$678,618 at December 31, 2017.

### ***Nonperforming Assets***

Nonperforming loans consist of non-accrual loans and loans that are past due 90 days or more and still accruing interest. Nonperforming assets consist of nonperforming loans plus OREO (i.e. real estate acquired through foreclosure or deed in lieu of foreclosure). Loans are placed on non-accrual status when they are past due 90 days and management believes the borrower's financial condition, after giving consideration to economic conditions and collection efforts, is such that collection of interest is doubtful. When a loan is placed on non-accrual status, interest accruals cease and uncollected interest is reversed and charged against current income. The interest on these loans is accounted for on the cash-basis, or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The primary component of nonperforming loans is non-accrual loans, which as of December 31, 2017 totaled \$2,837. The other component of nonperforming loans are loans past due greater than 90 days and still accruing interest. Loans past due greater than 90 days are placed on non-accrual status unless they are both well-secured and in the process of collection. There were outstanding loans totaling \$205 that were past due 90 days or more and still accruing interest at December 31, 2017.

The table below summarizes nonperforming loans and assets for the periods presented.

	December 31,				
	2017	2016	2015	2014	2013
Non-accrual loans	\$2,837	\$3,630	\$ 908	\$ 835	\$2,601
Past due loans 90 days or more and still accruing interest	205	2,552	2,378	316	—
<b>Total nonperforming loans</b>	<b>3,042</b>	<b>6,182</b>	<b>3,286</b>	<b>1,151</b>	<b>2,601</b>
Foreclosed real estate (“OREO”)	1,503	—	200	715	181
<b>Total nonperforming assets</b>	<b>\$4,545</b>	<b>\$6,182</b>	<b>\$3,486</b>	<b>\$1,866</b>	<b>\$2,782</b>
Total nonperforming loans as a percentage of total loans	0.1%	0.3%	0.3%	0.1%	0.6%
Total nonperforming assets as a percentage of total assets	0.1%	0.2%	0.2%	0.1%	0.3%
Allowance for loan losses as a percentage of nonperforming loans	698%	268%	353%	580%	188%

As of December 31, 2017, there were seven loans on non-accrual status. The amount and number are further delineated by collateral category and number of loans in the table below.

	Total Amount	Percentage of Total Non-Accrual Loans	Number of Non-Accrual Loans
Residential real estate	\$ 371	13.1%	2
Commercial & industrial	2,466	86.9%	5
Total non-accrual loans	\$ 2,837	100.0%	7

Troubled debt restructurings (TDRs) are modified loans in which a concession is provided to a borrower experiencing financial difficulties. Loan modifications are considered TDRs when the concession provided is not available to the borrower through either normal channels or other sources; however, not all loan modifications are TDRs. Our standards relating to loan modifications consider, among other factors, minimum verified income requirements, cash flow analysis, and collateral valuations; however, each potential loan modification is reviewed individually and the terms of the loan are modified to meet a borrower’s specific circumstances at a point in time. TDRs can be classified as either accrual or non-accrual loans. Non-accrual TDRs are included in non-accrual loans whereas accruing TDRs are excluded because the borrower remains contractually current. The Company had one loan for \$608 classified as an accrual TDR as of December 31, 2017, and Company had one loan for \$698 classified as an accrual TDR as of December 31, 2016.

Generally, loans that are current as to principal and interest are not included in our nonperforming assets categories; however, a loan that is current may be classified as a potential problem loan if it exhibits potential weaknesses and information about possible credit problems of the borrower that has caused management to have doubts about the borrower’s ability to comply with present repayment terms. This definition is believed to be consistent with the Company’s loan policy established for loans classified as special mention or worse and less than 90 days past due, but not considered nonperforming. Loans are assigned risk categories 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. Loans are analyzed individually when classifying the loans as to credit risk.

The following definitions are used for assigning risk ratings to loans:

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.

**Substandard.** Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They 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.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be “Pass” rated loans. All loans in all loan categories are assigned risk ratings. As of December 31, 2017, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

	(Dollars in Thousands)				
	Pass	Special Mention	Substandard	Doubtful	Total
Real estate loans:					
Construction and land development	\$ 494,601	\$ —	\$ 217	\$ —	\$ 494,818
Commercial	658,761	12,602	7,255	—	678,618
Residential	572,718	615	4,107	—	577,440
Total real estate	<u>1,726,080</u>	<u>13,217</u>	<u>11,579</u>	<u>—</u>	<u>1,750,876</u>
Commercial and industrial	485,363	10,350	8,201	—	503,914
Consumer and other	3,777	4	—	—	3,781
Total	<u>\$2,215,220</u>	<u>\$23,571</u>	<u>\$ 19,780</u>	<u>\$ —</u>	<u>\$2,258,571</u>

### **Investment Securities**

The investment securities portfolio is intended to provide the Company with adequate liquidity, flexible asset/liability management and a source of stable income. The portfolio is structured with the goal of minimizing credit exposure to the Company and consists of both securities classified as available-for-sale and securities classified as held-to-maturity. All available-for sale securities are carried at fair value and may be used for liquidity purposes should management deem it to be in the Company’s best interest. Securities available-for-sale, consisting primarily of U.S. government sponsored enterprises and mortgage-backed securities, were \$999,881 at December 31, 2017, compared to \$754,755 at December 31, 2016, an increase of \$245,126, or 32.5%. The increase in available-for-sale securities was primarily attributed to the Company’s strategy to provide tax-exempt income for the Company and to provide for pledging related to the growth of the Company’s public funds deposits.

The Company’s held-to-maturity securities are carried at amortized cost. This portfolio, consisting of U.S. government sponsored enterprises, mortgage-backed securities and municipal securities, totaled \$214,856 at December 31, 2017, compared to \$228,894 at December 31, 2016, a decrease of \$14,038, or 6.1%, primarily as a result of the paydowns on the U.S. government sponsored entities and mortgage-backed securities during 2017.

The combined portfolios represented 31.6% and 33.4% of total assets at December 31, 2017, and December 31, 2016, respectively. At December 31, 2017, the Company had no securities that were classified as having other than temporary impairment.

The following table summarizes the fair value of the available for sale securities portfolio at December 31, 2017 and 2016:

	December 31, 2017	December 31, 2016
U.S. government sponsored entities and agencies	\$ 19,961	\$ —
U.S. Treasury securities	228,909	—
Mortgage-backed securities: residential	632,566	607,085
Mortgage-backed securities: commercial	5,074	19,334
State and political subdivisions	113,371	128,336
<b>Total</b>	<b>\$ 999,881</b>	<b>\$ 754,755</b>

The following table summarizes the amortized cost of the held to maturity securities portfolio at December 31, 2017 and 2016:

	December 31, 2017	December 31, 2016
U.S. government sponsored entities and agencies	\$ —	\$ 203
Mortgage-backed securities: residential	93,366	106,169
State and political subdivisions	121,490	122,522
<b>Total</b>	<b>\$ 214,856</b>	<b>\$ 228,894</b>

The table below presents the maturities and yield characteristics of the Company's available-for-sale securities as of December 31, 2017. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	(Dollars in Thousands)					
	One Year or Less	Over One Year Through Five Years	Over Five Years Through Ten Years	Over Ten Years	Total Maturities	Fair Value
Mortgage-backed securities: residential <sup>(1)</sup>	\$ —	\$ 243,551	\$ 394,949	\$ 2,724	\$ 641,225	\$632,566
Mortgage-backed securities: commercial <sup>(1)</sup>	—	5,133	—	—	5,133	5,074
U.S. Treasury securities	229,119	—	—	—	229,119	228,909
U.S. government sponsored entities and agencies	—	20,125	—	—	20,125	19,961
State and political subdivisions	—	5,985	91,637	15,845	113,467	113,371
<b>Total available-for-sale securities</b>	<b>\$229,119</b>	<b>\$ 274,795</b>	<b>\$ 486,587</b>	<b>\$ 18,569</b>	<b>\$1,009,070</b>	<b>\$999,881</b>
Percent of total	22.71%	27.23%	48.22%	1.84%	100.00%	
Weighted average yield <sup>(2)</sup>	1.64%	2.32%	3.27%	4.40%	2.58%	

<sup>(1)</sup> Mortgage-backed securities are grouped into average lives based on December 2017 prepayment projections.

<sup>(2)</sup> The weighted average yields are based on amortized cost, and municipal securities are calculated on a fully tax-equivalent basis.

The table below presents the maturities and yield characteristics of the Company's held-to-maturity securities as of December 31, 2017. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	(Dollars in Thousands)					
	<u>One Year or Less</u>	<u>Over One Year Through Five Years</u>	<u>Over Five Years Through Ten Years</u>	<u>Over Ten Years</u>	<u>Total Maturities</u>	<u>Fair Value</u>
Mortgage-backed securities: residential <sup>(1)</sup>	\$ 739	\$ 7,769	\$ 84,301	\$ 557	\$ 93,366	\$ 91,777
State and political subdivisions	504	7,104	86,868	27,014	121,490	125,831
<b>Total held-to-maturity securities</b>	<b>\$ 1,243</b>	<b>\$ 14,873</b>	<b>\$ 171,169</b>	<b>\$ 27,571</b>	<b>\$ 214,856</b>	<b>\$ 217,608</b>
Percent of total	0.58%	6.92%	79.67%	12.83%	100.00%	
Weighted average yield <sup>(2)</sup>	3.23%	3.61%	4.27%	6.01%	4.44%	

<sup>(1)</sup> Mortgage-backed securities are grouped into average lives based on December 2017 prepayment projections.

<sup>(2)</sup> The weighted average yields are based on amortized cost and municipal securities are calculated on a fully tax-equivalent basis.

Securities pledged at December 31, 2017 and 2016 had a carrying amount of \$975,518 and \$808,224, respectively, and were pledged to secure public deposits and repurchase agreements.

At December 31, 2017 and 2016, there were no holdings of securities of any one issuer, other than the U.S. government-sponsored entities and agencies, in an amount greater than 10% of shareholders' equity.

#### ***Restricted Equity Securities***

The Company also had other investments of \$18,492 and \$11,843 at December 31, 2017, and December 31, 2016, respectively, consisting of capital stock in the Federal Reserve and the Federal Home Loan Bank (required as members of the Federal Reserve Bank System and the Federal Home Loan Bank System). The Federal Home Loan Bank and Federal Reserve investments are "restricted" in that they can only be sold back to the respective institutions or another member institution at par, and are thus, not liquid, have no ready market or quoted market value, and are carried at cost.

#### ***Bank Premises and Equipment***

Bank premises and equipment totaled \$11,281 at December 31, 2017 compared to \$9,551 at December 31, 2016, an increase of \$1,730, or 18.1%. This increase was primarily due to the addition of a new branch location in Murfreesboro, Tennessee and the relocation of a branch in Spring Hill, Tennessee.

#### ***Bank Owned Life Insurance***

As of December 31, 2017, the Company had \$49,085 in bank owned life insurance ("BOLI"), compared to \$23,267 at December 31, 2016. The increase in BOLI is primarily attributed to the purchase of additional policies in the amount of \$25,000 during October 2017, along with an increase in value due to earnings on the BOLI during 2017.

#### ***Goodwill and Intangible Assets***

As of December 31, 2017 and 2016, the Company had \$9,124 in goodwill. The goodwill is related to the acquisition of MidSouth Bank that occurred in 2014. At December 31, 2017, there were no circumstances or significant changes that have occurred related to that acquisition that, in management's assessment, would necessitate recording impairment of goodwill.

As of December 31, 2017 and 2016, the Company had net core deposit intangible of \$1,007 and \$1,480, respectively, all of which is attributed to the acquisition of MidSouth Bank. At the time of the acquisition, the Company recorded a core deposit intangible of \$3,060, and that intangible is being amortized over 8.2 years. Through December 31, 2017, the Company has recognized amortization of \$2,053 related to the core deposit intangible.

The following table represents acquired intangible assets at December 31, 2017 and 2016:

	2017		2016	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Acquired intangible assets:				
Core deposit intangibles	\$ 3,060	\$ (2,053)	\$ 3,060	\$ (1,580)

Aggregate amortization expense was \$473, \$563 and \$655 for 2017, 2016 and 2015, respectively.

The following table presents estimated amortization expense for each of the next five years:

2018	\$382
2019	\$291
2020	\$201
2021	\$110
2022	\$ 23

### Deposits

Deposits represent the Company's largest source of funds. The Company competes with other bank and nonbank institutions for deposits, as well as with a growing number of non-deposit investment alternatives available to depositors, such as mutual funds, money market funds, annuities, and other brokerage investment products. Challenges to deposit growth include price changes on deposit products given movements in the rate environment and other competitive pricing pressures, and customer preferences regarding higher-costing deposit products or non-deposit investment alternatives.

At December 31, 2017, total deposits were \$3,167,228, an increase of \$775,410, or 32.4%, compared to \$2,391,818 at December 31, 2016. Included in the Company's funding strategy are brokered deposits and public funds deposits. Total brokered deposits increased by 65.0%, to \$779,886, at December 31, 2017 when compared with \$472,515 at December 31, 2016. Public funds deposits increased 22.0% from \$822,081 at December 31, 2016 to \$1,002,584 at December 31, 2017, due to Company's focus on providing banking services to the municipalities in the counties in our primary service areas, Williamson County and Rutherford County, Tennessee.

Time deposits, excluding brokered deposits, as of December 31, 2017, amounted to \$675,150, as compared to \$555,732 as of December 31, 2016.

The average amounts for deposits for 2017, 2016 and 2015 are detailed in the following schedule.

	2017		2016		2015	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
<i>In thousands, except percentages</i>						
Non-interest-bearing deposits	\$ 252,276	— %	\$ 210,780	— %	\$ 164,284	— %
Interest-bearing checking accounts	624,612	0.80	332,285	0.42	268,745	0.30
Money market deposit accounts	627,140	1.04	617,036	0.62	464,588	0.56
Other savings	54,952	0.31	49,525	0.33	35,779	0.46
Time deposits	1,228,676	1.28	944,086	0.93	545,405	0.94
	<u>\$2,787,656</u>	<u>0.98%</u>	<u>\$2,153,712</u>	<u>0.66%</u>	<u>\$1,478,801</u>	<u>0.59%</u>



The following table shows time deposits, excluding brokered deposits, of \$100 or more by category based on time remaining until maturity.

	<u>December 31, 2017</u>
Three months or less	\$ 323,109
Over three months through six months	65,822
Over six months through 12 months	94,598
Over one year through three years	102,552
Over three years through five years	51,546
Over five years	—
Total	<u>\$ 637,627</u>

## Liquidity, Other Borrowings, and Capital Resources

### *Federal Funds Purchased and Repurchase Agreements*

As of December 31, 2017, the Company had no Federal funds purchased from correspondent banks compared to \$46,805 outstanding as of December 31, 2016.

Securities sold under agreements to repurchase had an outstanding balance of \$31,004 as of December 31, 2017, compared to \$36,496 as of December 31, 2016. Securities sold under agreements to repurchase are financing arrangements that typically mature daily. At maturity, the securities underlying the agreements are returned to the Company. The Company's repurchase agreements at December 31, 2017 and 2016 were composed of customer repurchase agreements. The weighted average rate for repurchase agreements was 1.14% as of December 31, 2017.

### *Federal Home Loan Bank Advances*

The Company has established a line of credit with the Federal Home Bank of Cincinnati which is secured by a blanket pledge of 1-4 family residential mortgages and home equity lines of credit. At December 31, 2017, advances totaled \$272,000 compared to \$132,000 as of December 31, 2016.

At December 31, 2017, the scheduled maturities of these advances and interest rates were as follows:

<u>Scheduled Maturities</u>	<u>Amount</u>	<u>Weighted Average Rates</u>
2018	\$157,000	1.19%
2019	60,000	1.46%
2020	55,000	1.72%
Total	<u>\$272,000</u>	<u>1.36%</u>

### *Subordinated Notes*

The Company completed the issuance of \$60,000 in principal amount of subordinated notes in two separate issuances. In March 2016, \$40,000 of 6.875% fixed-to-floating rate subordinated notes were issued in a public offering to accredited institutional investors, and in June 2016, \$20,000 of 7.00% fixed-to-floating rate subordinated notes were issued to certain accredited institutional investors in a private offering. At December 31, 2017, the Company's subordinated notes, net of issuance costs, totaled \$58,515 as compared to \$58,337 at December 31, 2016. For regulatory capital purposes, the subordinated notes are treated as Tier 2 capital, subject to certain limitations, and are included in total regulatory capital when calculating the Company's total capital to risk weighted assets ratio as indicated in Note 15 of the consolidated financial statements.

The subordinated notes are unsecured and will rank at least equally with all of the Company's other unsecured subordinated indebtedness and will be effectively subordinated to all of our secured debt to the extent of the value of the collateral securing such debt. The subordinated notes will be subordinated in right of payment to all of our existing and future senior indebtedness, and will rank structurally junior to all existing and future liabilities of our subsidiaries including, in the case of the Company's bank subsidiary, its depositors, and any preferred equity holders of our subsidiaries. The holders of the Subordinated Notes may be fully subordinated to interests held by the U.S. government in the event that we enter into a receivership, insolvency, liquidation, or similar proceeding.

The following table summarizes the terms of each subordinated note offering:

	<u>March 2016 Subordinated Notes</u>	<u>June 2016 Subordinated Notes</u>
Principal amount issued	\$40,000	\$20,000
Maturity date	March 30, 2026	July 1, 2026
Initial fixed interest rate	6.875%	7.00%
Initial interest rate period	5 years	5 years
First interest rate change date	March 30, 2021	July 1, 2021
Interest repricing index and margin	3-month LIBOR plus 5.636%	3-month LIBOR plus 6.04%
Repricing frequency	Quarterly	Quarterly

For more detail related to the subordinated notes, please see Note 10 of the consolidated financial statements.

### **Capital**

Shareholders' equity was \$304,550 at December 31, 2017, an increase of \$34,292, or 12.7%, from \$270,258 at December 31, 2016. No common dividends were paid during 2017.

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally 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. Failure to meet capital requirements can initiate regulatory action.

The final rules implementing the Basel Committee on Banking Supervision's capital guidelines 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. Under the Basel III rules, in order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers, a banking organization must hold a capital conservation buffer composed of Common Equity Tier 1 capital above its minimum risk-based capital requirements. The buffer is measured relative to RWA. Phase-in of the capital conservation buffer requirements began on January 1, 2016 and the requirements will be fully phased in on January 1, 2019. The capital conservation buffer threshold for 2017 was 1.25%. A banking organization with a buffer greater than 2.5% once the capital conservation buffer is fully phased in would not be subject to limits on capital distributions or discretionary bonus payments; however, a banking organization with a buffer of less than 2.5% would be subject to increasingly stringent limitations as the buffer approaches zero. The rule also prohibits a banking organization from making distributions or discretionary bonus payments during any quarter if its eligible retained income is negative in that quarter and its capital conservation buffer ratio was less than 2.5% at the beginning of the quarter. Effectively, the Basel III framework will require us to meet minimum capital ratios of (i) 7% for Common Equity Tier 1 capital, (ii) 8.5% Tier 1 capital, and (iii) 10.5% Total Capital. The eligible retained income of a banking organization is defined as its net income for the four calendar quarters preceding the current calendar quarter, based on the organization's quarterly regulatory reports, net of any distributions and associated tax effects not already reflected in net income. When the new rule is fully phased in, the minimum capital requirements plus the capital conservation buffer will exceed the prompt corrective action ("PCA") well-capitalized thresholds.

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. At December 31, 2017, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

Management believes as of December 31, 2017, the Company and Bank meet all capital adequacy requirements to which they are subject. Actual and required capital amounts and ratios are presented below as of December 31, 2017 and 2016 for the Company and Bank.

	<u>Actual</u>		<u>Required For Capital Adequacy Purposes</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Regulations</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>December 31, 2017</u>						
Company common equity Tier 1 capital to risk-weighted assets	\$299,229	11.37%	\$ 118,479	4.50%	N/A	N/A
Company Total Capital to risk weighted assets	\$379,083	14.40%	\$ 210,629	8.00%	N/A	N/A
Company Tier 1 (Core) Capital to risk weighted assets	\$299,229	11.37%	\$ 157,972	6.00%	N/A	N/A
Company Tier 1 (Core) Capital to average assets	\$299,229	8.25%	\$ 145,100	4.00%	N/A	N/A
Bank common equity Tier 1 capital to risk-weighted assets	\$353,512	13.43%	\$ 118,489	4.50%	\$171,151	6.50%
Bank Total Capital to risk weighted assets	\$374,851	14.24%	\$ 210,647	8.00%	\$263,309	10.00%
Bank Tier 1 (Core) Capital to risk weighted assets	\$353,512	13.43%	\$ 157,985	6.00%	\$210,647	8.00%
Bank Tier 1 (Core) Capital to average assets	\$353,512	9.75%	\$ 145,003	4.00%	\$181,253	5.00%
<u>December 31, 2016</u>						
Company common equity Tier 1 capital to risk-weighted assets	\$263,693	11.75%	\$ 101,022	4.50%	N/A	N/A
Company Total Capital to risk weighted assets	\$338,675	15.09%	\$ 179,595	8.00%	N/A	N/A
Company Tier 1 (Core) Capital to risk weighted assets	\$263,693	11.75%	\$ 134,696	6.00%	N/A	N/A
Company Tier 1 (Core) Capital to average assets	\$263,693	9.28%	\$ 113,697	4.00%	N/A	N/A
Bank common equity Tier 1 capital to risk-weighted assets	\$319,005	14.18%	\$ 101,216	4.50%	\$146,201	6.50%
Bank Total Capital to risk weighted assets	\$335,650	14.92%	\$ 179,939	8.00%	\$224,924	10.00%
Bank Tier 1 (Core) Capital to risk weighted assets	\$319,005	14.18%	\$ 134,954	6.00%	\$179,939	8.00%
Bank Tier 1 (Core) Capital to average assets	\$319,005	11.22%	\$ 113,697	4.00%	\$142,122	5.00%

Note: Minimum ratios presented exclude the capital conservation buffer.

### **Contractual Obligations**

The following table summarizes our contractual obligations and other commitments to make future payments as of December 31, 2017:

	<u>(Dollars in Thousands)</u>				
	<u>One Year or Less</u>	<u>More Than One Year but Less Than Three years</u>	<u>More Than Three Years but Less Than Five Years</u>	<u>Five Years or More</u>	<u>Total</u>
As of December 31, 2017					
Time deposits	\$ 875,033	\$ 259,069	\$ 96,334	\$ —	\$1,230,436
Federal funds purchased and repurchase agreements	31,004	—	—	—	31,004
FHLB advances	157,000	115,000	—	—	272,000
Subordinated notes	—	—	—	60,000	60,000
Lease commitments	4,523	9,085	9,227	38,150	60,985
<b>Total</b>	<b>\$1,067,560</b>	<b>\$ 383,154</b>	<b>\$ 105,561</b>	<b>\$ 98,150</b>	<b>\$1,654,425</b>

FHLB advances include arrangements under various FHLB credit programs. Long-term FHLB debt is more fully described under the caption “Federal Home Loan Bank Advances” in Note 9 of our Consolidated Financial Statements. Subordinated notes include two issuances that occurred in the first and second quarters of 2016, respectively. The subordinated notes are more fully described in Note 10, “Subordinated Notes” of our Consolidated Financial Statements. Lease commitments include the leases in place for certain branch sites.

## Interest Rate Sensitivity

The following schedule details the Company's interest rate sensitivity at December 31, 2017:

<i>(In Thousands, Except Percentages)</i>	Total	Repricing Within			
		1-90 Days	3 months to 12 months	1 to 5 years	Over 5 years
<b>Earning assets:</b>					
Loans, net of unearned income <sup>†</sup>	\$2,253,771	\$ 974,824	\$ 169,066	\$ 579,321	\$ 530,560
Available for sale securities	999,881	—	228,909	271,802	499,170
Held to maturity securities	214,856	178	1,065	14,873	198,740
Loans held for sale	12,024	—	—	—	12,024
Interest-bearing deposits at other financial institutions	218,693	218,693	—	—	—
Certificates of deposit at other financial institutions	2,855	490	395	1,470	500
<b>Total earning assets</b>	<b>3,702,080</b>	<b>1,194,185</b>	<b>399,435</b>	<b>867,466</b>	<b>1,240,994</b>
<b>Interest-bearing liabilities:</b>					
<b>Deposits:</b>					
Interest-bearing checking accounts	849,992	849,992	—	—	—
Money market deposit accounts	763,375	763,375	—	—	—
Other savings	51,404	51,404	—	—	—
IRA's and certificates of deposit, \$250,000 and over	821,269	271,488	324,949	224,832	—
IRA's and certificates of deposit, under \$250,000	409,166	121,990	156,605	130,571	—
Federal funds purchased	—	—	—	—	—
Securities sold under agreement to repurchase	31,004	31,004	—	—	—
FHLB borrowings	272,000	50,000	107,000	115,000	—
Subordinated notes	58,515	—	—	58,515	—
<b>Total interest-bearing liabilities</b>	<b>3,256,725</b>	<b>2,139,253</b>	<b>588,554</b>	<b>528,918</b>	<b>—</b>
Interest-sensitivity gap		<u>\$ (945,068)</u>	<u>\$ (189,119)</u>	<u>\$ 338,548</u>	<u>\$1,240,994</u>
Cumulative gap		<u>\$ (945,068)</u>	<u>\$ (1,134,187)</u>	<u>\$ (795,639)</u>	<u>\$ 445,355</u>
Interest-sensitivity gap as % of total average assets		<u>(27.43)%</u>	<u>(5.49)%</u>	<u>9.83%</u>	<u>36.02%</u>
Cumulative gap as % of total average assets		<u>(27.43)%</u>	<u>(32.92)%</u>	<u>(23.09)%</u>	<u>12.93%</u>

<sup>†</sup> Loans, net of unearned income excludes non-accrual loans.

## ***Liquidity***

Liquidity is defined as the ability to meet anticipated customer demands for funds under credit commitments and deposit withdrawals at a reasonable cost and on a timely basis.

Liquidity risk involves the risk of being unable to fund assets with the appropriate duration and rate-based liabilities, as well as the risk of not being able to meet unexpected cash needs. Liquidity planning and management are necessary to ensure the ability to fund operations cost-effectively and to meet current and future potential obligations such as loan commitments, lease obligations, and unexpected deposit outflows. In this process, management focuses on both assets and liabilities and on the manner in which they combine to provide adequate liquidity to meet the Company's needs. Our source of funds to pay interest on our March 2016 Notes and June 2016 Notes is generally in the form of a dividend from the Bank to the Company, or those payments may be serviced from cash balances held by the Company. Under the terms of the informal agreement with the Reserve Bank, described in "Other Events" in Management's Discussion and Analysis and in "ITEM 1A. RISK FACTORS," the Bank is required to receive prior written approval from its regulatory agencies to pay dividends to the Company.

Funds are available from a number of basic banking activity sources including the core deposit base, the repayment and maturity of loans, payments of principal and interest as well as sales of investments classified as available-for-sale, and sales of brokered deposits. As of December 31, 2017, \$999,881 of the investment securities portfolio was classified as available-for-sale and is reported at fair value on the consolidated balance sheet. Another \$214,856 of the portfolio was classified as held-to-maturity and is reported at amortized cost. Approximately \$975,518 of the total \$1,214,737 investment securities portfolio on hand at December 31, 2017, was pledged to secure public deposits and repurchase agreements. Other funding sources available include repurchase agreements, federal funds purchased, and borrowings from the Federal Home Loan Bank.

## ***Effects of Inflation and Changing Prices***

The accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant impact on the performance of a financial institution than the effects of general levels of inflation. Although interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services, increases in inflation generally have resulted in increased interest rates. In addition, inflation affects financial institutions' increased cost of goods and services purchased, the cost of salaries and benefits, occupancy expense, and similar items. Inflation and related increases in interest rates generally decrease the market value of investments and loans held and may adversely affect liquidity, earnings, and shareholders' equity. Commercial and other loan originations and refinancings tend to slow as interest rates increase, and can reduce the Company's earnings from such activities.

## ***Off Balance Sheet Arrangements***

The Company generally does not have any off-balance sheet arrangements other than approved and unfunded loans and lines and letters of credit to customers in the ordinary course of business. At December 31, 2017, the Company had unfunded loan commitments outstanding of \$21,656, unused lines of credit of \$605,181, and outstanding standby letters of credit of \$45,624.

## ***GAAP Reconciliation and Management Explanation of Non-GAAP Financial Measures***

Some of the financial data included in our selected historical consolidated financial information are not measures of financial performance recognized by GAAP. Our management uses these non-GAAP financial measures in its analysis of our performance:

- "Common shareholders' equity" is defined as total shareholders' equity at end of period less the liquidation preference value of the preferred stock;
- "Tangible common shareholders' equity" is common shareholders' equity less goodwill and other intangible assets;
- "Total tangible assets" is defined as total assets less goodwill and other intangible assets;
- "Other intangible assets" is defined as the sum of core deposit intangible and SBA servicing rights;
- "Tangible book value per share" is defined as tangible common shareholders' equity divided by total common shares outstanding. This measure is important to investors interested in changes from period-to-period in book value per share exclusive of changes in intangible assets;

- “Tangible common shareholders’ equity ratio” is defined as the ratio of tangible common shareholders’ equity divided by total tangible assets. We believe that this measure is important to many investors in the marketplace who are interested in relative changes from period-to period in common equity and total assets, each exclusive of changes in intangible assets;
- “Return on Average Tangible Common Equity” is defined as net income available to common shareholders divided by average tangible common shareholders’ equity;
- “Efficiency ratio” is defined as noninterest expenses divided by our operating revenue, which is equal to net interest income plus noninterest income;
- “Adjusted yield on loans” is our yield on loans after excluding loan accretion from our acquired loan portfolio. Our management uses this metric to better assess the impact of purchase accounting on our yield on loans, as the effect of loan discount accretion is expected to decrease as the acquired loans mature or roll off of our balance sheet;
- “Net interest margin” is defined as annualized net interest income divided by average interest-earning assets for the period; and
- “Adjusted net interest margin” is net interest margin after excluding loan accretion from the acquired loan portfolio and premiums for acquired time deposits. Our management uses this metric to better assess the impact of purchase accounting on net interest margin, as the effect of loan discount accretion and accretion of net discounts and premiums related to deposits is expected to decrease as the acquired loans and deposits mature or roll off of our balance sheet.

We believe these non-GAAP financial measures provide useful information to management and investors that is supplementary to our financial condition, results of operations and cash flows computed in accordance with GAAP; however, we acknowledge that our non-GAAP financial measures have a number of limitations. As such, you should not view these disclosures as a substitute for results determined in accordance with GAAP, and they are not necessarily comparable to non-GAAP financial measures that other companies use.

The following reconciliation table provides a more detailed analysis of these non-GAAP financial measures:

	<u>As of or for the Years Ended</u>		
	<u>December 31, 2017</u>	<u>December 31, 2016</u>	<u>December 31, 2015</u>
<b>(Amounts in thousands, except share/per share data and percentages)</b>			
Total shareholders’ equity	\$ 304,550	\$ 270,258	\$ 188,816
Less: Preferred stock	—	—	10,000
<i>Total common shareholders’ equity</i>	<u>304,550</u>	<u>270,258</u>	<u>178,816</u>
Less: Goodwill and other intangible assets	10,181	10,633	11,231
Tangible common shareholders’ equity	\$ 294,369	\$ 259,625	\$ 167,585
Common shares outstanding	<u>13,237,128</u>	<u>13,036,954</u>	<u>10,571,377</u>
<i>Tangible book value per common share</i>	<u>\$ 22.24</u>	<u>\$ 19.91</u>	<u>\$ 15.85</u>
Net income available to common shareholders	\$ 28,083	\$ 28,034	\$ 15,980
Average tangible common equity	<u>279,098</u>	<u>194,529</u>	<u>147,374</u>
<i>Return on average tangible common equity</i>	<u>10.06%</u>	<u>14.41%</u>	<u>10.84%</u>
<i>Efficiency Ratio:</i>			
Net interest income	\$ 97,046	\$ 81,584	\$ 59,415
Noninterest income	<u>14,721</u>	<u>15,140</u>	<u>12,830</u>
Operating revenue	111,767	96,724	72,245
Expense			
Total noninterest expense	<u>60,824</u>	<u>51,681</u>	<u>42,114</u>
<i>Efficiency ratio</i>	<u>54.42%</u>	<u>53.43%</u>	<u>58.29%</u>

### ***Emerging Growth Company Status***

The Company is an “emerging growth company,” as defined in the Jumpstart Our Business Startups Act of 2012 (the “JOBS Act”), and may take advantage of certain exemptions from various reporting requirements that are applicable to public companies that are not emerging growth companies, including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and shareholder approval of any golden parachute payments not previously approved. In addition, even if the Company complies with the greater obligations of public companies that are not emerging growth companies, the Company may avail itself of the reduced requirements applicable to emerging growth companies from time to time in the future, so long as the Company is an emerging growth company. The Company will continue to be an emerging growth company until the earliest to occur of: (1) the end of the fiscal year following the fifth anniversary of the effectiveness of our Form S-4, which was declared effective by the SEC on May 14, 2014; (2) the last day of the fiscal year in which we have more than \$1.07 billion in annual revenues; (3) the date on which we are deemed to be a “large accelerated filer” under the Exchange Act; or (4) the date on which we have, during the previous three-year period, issued publicly or privately, more than \$1.0 billion in non-convertible debt securities. Management cannot predict if investors will find the Company’s common stock less attractive because it will rely on these exemptions. If some investors find the Company’s common stock less attractive as a result, there may be a less active trading market for its common stock and the Company’s stock price may be more volatile.

Further, the JOBS Act exempts emerging growth companies from being required to comply with new or revised financial accounting standards until private companies (that is, those that have not had a Securities Act registration statement declared effective and do not have a class of securities registered under the Exchange Act) are required to comply with the new or revised financial accounting standards. The JOBS Act provides that a company can elect to opt out of the extended transition period and comply with the requirements that apply to non-emerging growth companies but any such an election to opt out is irrevocable. The Company has elected to opt out of such extended transition period, which means that when a standard is issued or revised and it has different application dates for public or private companies, it adopts the new or revised standard at the time public companies adopt the new or revised standard. This election is irrevocable.

### ***Adoption of New Accounting Standards***

In March 2016, the FASB issued *ASU 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. Under ASU 2016-09 all excess tax benefits and tax deficiencies related to share-based payment awards should be recognized as income tax expense or benefit in the income statement during the period in which they occur. Previously, such amounts were recorded in the pool of excess tax benefits included in additional paid-in capital, if such pool was available. Because excess tax benefits are no longer recognized in additional paid-in capital, the assumed proceeds from applying the treasury stock method when computing earnings per share should exclude the amount of excess tax benefits that would have previously been recognized in additional paid-in capital. Additionally, excess tax benefits should be classified along with other income tax cash flows as an operating activity rather than a financing activity, as was previously the case. ASU 2016-09 also provides that an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur. ASU 2016-09 changes the threshold to qualify for equity classification (rather than as a liability) to permit withholding up to the maximum statutory tax rates (rather than the minimum as was previously the case) in the applicable jurisdictions. The Company elected to adopt this ASU in the fourth quarter of 2016 effective as of January 1, 2016. The adoption of this ASU decreased income tax expense for 2016 by \$1,013 and had no impact for 2017.

In February 2018, the FASB issued Accounting Standards Update (“ASU”) 2018-02, *Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. The amendments in this ASU addressed the income tax accounting treatment of the stranded tax effects within other comprehensive income due to the newly enacted federal corporate tax rate included in the Tax Cuts and Jobs Act issued December 22, 2017. These amendments allow an entity to make a reclassification from other comprehensive income to retained earnings for the difference between the historical corporate income tax rate and the newly enacted corporate income tax rate. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those years. The Company elected to adopt this ASU early. The impact of the new guidance on the Company’s consolidated financial statements was a reclassification of \$1,202 between retained earnings and other comprehensive income at December 31, 2017.

### ***Accounting Standards Issued, But Not Yet Effective***

In May 2014, the FASB issued Accounting Standards Update 2014-09, *Revenue from Contracts with Customers (Topic 606): Revenue from Contracts with Customers*. ASU 2014-09 created a new topic in the FASB Accounting Standards Codification® (“ASC”), Topic 606. In addition to superseding and replacing nearly all existing U.S. GAAP revenue recognition guidance, including industry-specific guidance, ASU 2014-09 established a new control-based revenue

recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, provides new and more detailed guidance on specific topics and expands and improves disclosures about revenue. In addition, ASU 2014-09 added a new Subtopic to the ASC, *Other Assets and Deferred Costs: Contracts with Customers* (“ASC 340-40”), to provide guidance on costs related to obtaining a contract with a customer and costs incurred in fulfilling a contract with a customer that are not in the scope of another ASC Topic. The new guidance does not apply to certain contracts within the scope of other ASC Topics, such as lease contracts, insurance contracts, financing arrangements, financial instruments, guarantees other than product or service warranties, and non-monetary exchanges between entities in the same line of business to facilitate sales to customers. The Company’s sources of non-interest income that fall within the scope of the new standard, such as service charges on deposit accounts, debit card interchange income, wealth management fees, and gain on sale of foreclosed property, are all immaterial in comparison with total revenue and are structured in a way that the non-interest income is not earned over a period of time, which is similar to the treatment under previous revenue recognition standards. The Company adopted ASU 2014-09 and applied the modified retrospective approach with a cumulative effect of initial application in the first quarter of 2018 but there was no impact to retained earnings as a result of the adopting the new standard.

In January 2016, FASB issued ASU 2016-01, *Financial Instruments (Topic 825): Recognition and Measurement of Financial Assets and Financial Liabilities*, which amends prior guidance to require an entity to measure its equity investments (except those accounted for under the equity method of accounting) to be measured at fair value with changes in fair value recognized in net income. An entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment of same issuer. The new guidance simplifies the impairment assessment of equity investments without readily determinable fair values, requires public entities to use the exit price notion when measuring fair value of financial instruments for disclosure purposes, requires an entity to present separately in other comprehensive income the portion of the total change in fair value of a liability resulting from changes in the instrument-specific credit risk when the entity has selected fair value option for financial instruments and requires separate presentation of financial assets and liabilities by measurement category and form of financial asset. ASU 2016-01 was effective for the Company on January 1, 2018 and is not expected to have a significant impact on our consolidated financial statements and related disclosures.

On February 25, 2016, FASB issued ASU 2016-02 which creates *Topic 842, Leases* and supersedes *Topic 840, Leases*. ASU 2016-02 is intended to improve financial reporting about leasing transactions, by increasing transparency and comparability among organizations. Under the new guidance, a lessee will be required to record all leases with lease terms of more than 12 months on their balance sheet as lease liabilities with a corresponding right-of-use asset. ASU 2016-02 maintains the dual model for lease accounting, requiring leases to be classified as either operating or finance, with lease classification determined in a manner similar to existing lease guidance. The new guidance will be effective for public companies for fiscal years beginning on or after December 15, 2018, and for private companies for fiscal years beginning on or after December 15, 2019. Early adoption is permitted for all entities. At the time this ASU is adopted, the Company will recognize a right-of-use asset and a lease liability for all leases, which will initially be measured at the present value of lease payments, and a single lease cost calculated so that the costs of the leases are allocated over the terms of the Company’s leases on a generally straight-line basis. Since an asset will be recognized at the time of adoption, the Company’s regulatory capital ratios will likely be impacted. Management is evaluating the impact ASU 2016-02 will have on the Company’s financial statements.

In June 2016, FASB issued *ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The ASU 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 inform 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. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. The ASU requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The ASU is effective for the Company for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019 (i.e., January 1, 2020, for calendar year entities). Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018; however, the Company does not currently plan to early adopt this ASU. The Company is currently gathering information, reviewing possible vendors and working to determine the methodology to be used. The Company is gathering as much data as possible to enable review scenarios and to determine which calculations will produce the most reliable results. The impact of adopting ASU 2016-13 is not currently known.

In August 2016, FASB issued *ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. This Accounting Standards Update addresses the following eight specific cash flow issues: Debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (COLIs) (including bank-owned life insurance policies (BOLIs)); distributions received from equity method investees;



beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The amendments in this Update were effective for the Company January 1, 2018, but it is not expected to have a material impact on the Company's financial statements.

In January 2017, the FASB issued *Accounting Standards Update 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business*. The amendment in this ASU clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) or assets or businesses. The amendments are effective for fiscal years beginning after December 15, 2017, including interim periods within those periods. This ASU is not expected impact the Company's consolidated financial statements.

In January 2017, the FASB issued Accounting Standards Update No. 2017-04, *Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*, to simplify how entities other than private companies, such as public business entities and not-for-profit entities, are required to test goodwill for impairment by eliminating the comparison of the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. The amendments are effective for fiscal years beginning after December 15, 2019, including interim periods within those periods. Adoption of this standard is not expected to have a material impact on the Company's 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*. These amendments shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The guidance is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted with modified retrospective application; however, the Company is not expecting to early adopt. The Company is currently evaluating the impact of the new guidance on its consolidated financial statements.

In August 2017, the FASB issued ASU 2017-12, *Targeted Improvements to Accounting for Hedging Activities*. The objective of this ASU is to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition to that main objective, the amendments in this Update make certain targeted improvements to simplify the application of the hedge accounting guidance in current GAAP. This Update is effective for public business entities for fiscal years beginning after December 15, 2018, and early application is permitted in any interim period after issuance of the Update. The Company currently does not have any hedging activities that would be subject to this Update; however, management may consider hedging activities in the future. Adoption of this Update is not expected to have a material impact on the Company's consolidated financial statements.

## **Other Events**

On November 3, 2016, the Bank entered into an informal agreement with the Reserve Bank and the TDFI in the form of a Memorandum of Understanding ("MOU"). Under the terms of the MOU, the Bank agreed, among other things, to (1) enhance and periodically update its Commercial Real Estate ("CRE") concentration risk management policy; (2) augment credit risk management practices; and (3) enhance capital and liquidity plans. The Bank has also agreed that it will seek prior written approval of the Reserve Bank and the TDFI to pay dividends to the Company, which dividends are used primarily for the purpose of servicing the Company's subordinated debt. In addition, the Company currently may not make interest payments on its subordinated debt without prior written approval from its primary regulatory agencies.

The Company has also executed an agreement with the Board of Governors of the Federal Reserve System (the "Agreement") under section 4(m)(2) of the Bank Holding Company Act, which includes specific actions designed to address the Bank's risk profile and to strengthen the underlying condition of the Bank. Until the Bank and Company satisfy the requirements of the MOU and the Agreement, any plans for business combinations or location expansion will be limited and subject to prior written approval from the appropriate regulatory body.

Management believes the effect of these regulatory actions will not have a material impact on the Bank's ability to continue to serve its customers and communities. In addition, the Company's ongoing investment in its people and technology has and will continue to support solid growth, asset quality measures, and safety and soundness standards.

## **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

Our primary component of market risk is interest rate volatility. Fluctuations in interest rates will ultimately impact both the level of income and expense recorded on a large portion of our assets and liabilities, and the market value of all interest-earning assets and interest-bearing liabilities, other than those which possess a short term to maturity. Based upon the nature of our operations, we are not subject to foreign currency exchange or commodity price risk.

Management seeks to maintain profitability in both immediate and long-term earnings through funds management/interest rate risk management. Interest rate risk (sensitivity) management deals with the potential impact on earnings associated with changing interest rates using various rate change (shock) scenarios. Our rate sensitivity position has an important impact on earnings. Senior management monitors our rate sensitivity position throughout each month, and the Asset Liability Committee (“ALCO”) of the Bank meets on a quarterly basis to analyze the rate sensitivity position and other aspects of asset/liability management. These meetings cover the spread between the cost of funds and interest yields generated primarily through loans and investments, rate shock analyses, liquidity and dependency positions, and other areas necessary for proper balance sheet management.

Management believes interest rate risk is best measured by earnings simulation modeling. The simulation is run using the prime rate as the base with the assumption of rates increasing 100, 200, 300 and 400 basis points or decreasing 100 and 200 basis points. All rates are increased or decreased parallel to the change in prime rate. As a result of the simulation, over a 12-month time period ending December 31, 2017, net interest income was estimated to decrease 1.64% and 3.96% if rates were to increase 100 basis points and 200 basis points, respectively, and was estimated to increase 0.52% and decrease 6.15% in a 100 basis points and 200 basis points declining rate assumption, respectively. These results are in line with the Company’s guidelines for rate sensitivity.

The following chart reflects the Company’s sensitivity to changes in interest rates as indicated as of December 31, 2017.

<u>Projected Interest Rate Change</u>	<u>Net Interest Income</u>	<u>Net Interest Income \$ Change from Base</u>	<u>% Change from Base</u>
-200	97,881	(6,412)	(6.15)
-100	104,831	538	0.52
Base	104,293	—	0.00
+100	102,586	(1,707)	(1.64)
+200	100,161	(4,131)	(3.96)
+300	97,370	(6,923)	(6.64)
+400	95,426	(8,867)	(8.50)

The preceding sensitivity analysis is a modeling analysis, which changes periodically and consists of hypothetical estimates based upon numerous assumptions including interest rate levels, changes in the shape of the yield curve, prepayments on loans and spreads between key market rates, and other assumptions. In addition, there is no input for growth or a change in asset mix. While assumptions are developed based on the current economic and market conditions, the Company cannot make any assurances as to the predictive nature of these assumptions, including how customer preferences or competitor influences might change. As market conditions vary from those assumed in the sensitivity analysis, actual results will differ. Also, these results do not include any management action that might be taken in responding to or anticipating changes in interest rates. The simulation results are one indicator of interest rate risk, and actual net interest income is largely impacted by the allocation of assets, liabilities, and product mix.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

The financial statements required by this Item are included as a separate section of this report commencing on page F-1.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None.

**ITEM 9A. CONTROLS AND PROCEDURES.**

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our principal executive officer and principal financial officer, has concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) were effective as of December 31, 2017, based on the evaluation of these controls and procedures required by Rule 13a-15(b) or 15d-15(b) of the Exchange Act.

**Management’s Report on Internal Control Over Financial Reporting**

The management of Franklin Financial Network, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Franklin Financial Network, Inc.’s internal control system was designed to provide reasonable assurance to the Company’s management and Board of Directors regarding the

preparation and fair presentation of published financial statements. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Franklin Financial Network, Inc.'s management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2017. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework (2013).

Based on our assessment we believe that, as of December 31, 2017, the Company's internal control over financial reporting was effective based on those criteria.

This Annual Report on Form 10-K does not include an attestation report of the Company's registered public accounting firm due to a transition period established by rules of the SEC for an emerging growth company.

#### **Changes in Internal Control Over Financial Reporting**

There was no change in our internal control over financial reporting that occurred during the fourth quarter of 2017 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

#### **ITEM 9B. OTHER INFORMATION.**

None.

### **PART III**

#### **ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.**

The information called for by this item is incorporated herein by reference to the definitive Proxy Statement for our Annual Meeting of Stockholders to be held on May 24, 2018, which will be filed with the SEC pursuant to Regulation 14A under the Exchange Act.

#### **ITEM 11. EXECUTIVE COMPENSATION.**

The information called for by this item is incorporated herein by reference to the definitive Proxy Statement for our Annual Meeting of Stockholders to be held on May 24, 2018, which will be filed with the SEC pursuant to Regulation 14A under the Exchange Act.

#### **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.**

The information called for by this item is incorporated herein by reference to the definitive Proxy Statement for our Annual Meeting of Stockholders to be held on May 24, 2018, which will be filed with the SEC pursuant to Regulation 14A under the Exchange Act.

#### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.**

The information called for by this item is incorporated herein by reference to the definitive Proxy Statement for our Annual Meeting of Stockholders to be held on May 24, 2018, which will be filed with the SEC pursuant to Regulation 14A under the Exchange Act.

#### **ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.**

The information called for by this item is incorporated herein by reference to the definitive Proxy Statement for our Annual Meeting of Stockholders to be held on May 24, 2018, which will be filed with the SEC pursuant to Regulation 14A under the Exchange Act.

## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.

#### Financial Statements

The list of financial statements contained herein is set forth on page F-1 hereof.

#### Financial Statement Schedules

None

#### Exhibits

The Exhibits are listed in the Exhibit Index required by Item 601 of Regulation S-K preceding the signature page of this report.

### ITEM 16. FORM 10-K SUMMARY.

None.

## EXHIBIT INDEX

<u>Exhibit No.</u>	<u>Description of Exhibit</u>
2.1	<a href="#"><u>Agreement and Plan of Reorganization and Bank Merger, dated as of November 21, 2013, between Franklin Financial Network, Inc., Franklin Synergy Bank and MidSouth Bank (incorporated herein by reference to Appendix A to Form S-4 (File No. 333-193951) filed with the Securities and Exchange Commission on February 14, 2014) (schedules and exhibits to which have been omitted pursuant to Item 601(b)(2) of Regulations S-K).</u></a>
2.2	<a href="#"><u>Agreement and Plan of Reorganization and Bank Merger, dated as of December 14, 2015 among Franklin Financial Network, Inc., Franklin Synergy Bank and Civic Bank &amp; Trust (incorporated herein by reference to Exhibit 2.1 to Form 8-K (File No. 001-36895) filed with the Securities and Exchange Commission on December 14, 2015) (schedules and exhibits to which have been omitted pursuant to Item 601(b)(2) of Regulations S-K).</u></a>
2.3	<a href="#"><u>Amendment No. 1 to the Agreement and Plan of Reorganization and Bank Merger, dated May 9, 2016, among Civic Bank &amp; Trust, Franklin Financial Network, Inc. and Franklin Synergy Bank (incorporated herein by reference to Exhibit 2.1 to Form 10-Q (File No. 001-36895) filed with the Securities and Exchange Commission on May 10, 2016).</u></a>
2.4	<a href="#"><u>Amendment No. 2 to the Agreement and Plan of Reorganization and Bank Merger, dated March 30, 2017 (incorporated by reference to Exhibit 2.1 to Form 8-K (File No. 001-36895) filed with the Securities and Exchange Commission on March 31, 2017).</u></a>
2.5	<a href="#"><u>Amendment No. 3 to the Agreement and Plan of Reorganization and Bank Merger, dated September 29, 2017 (incorporated by reference to Exhibit 2.1 to Form 8-K (File No. 001-36895) filed with the Securities and Exchange Commission on October 5, 2017).</u></a>
3.1	<a href="#"><u>Charter of Franklin Financial Network, Inc. (incorporated herein by reference to Exhibit 3.1 to Form S-4 (File No. 333-193951) filed with the Securities and Exchange Commission on February 14, 2014).</u></a>
3.2	<a href="#"><u>Articles of Amendment to the Charter of Franklin Financial Network, Inc., dated November 15, 2007 (incorporated herein by reference to Exhibit 3.2 to Form S-4 (File No. 333-193951) filed with the Securities and Exchange Commission on February 14, 2014).</u></a>
3.3	<a href="#"><u>Articles of Amendment to the Charter of Franklin Financial Network, Inc., dated June 17, 2010 (incorporated herein by reference to Exhibit 3.3 to Form S-4 (File No. 333-193951) filed with the Securities and Exchange Commission on February 14, 2014).</u></a>
3.4	<a href="#"><u>Articles of Amendment to the Charter of Franklin Financial Network, Inc., dated September 27, 2011 (incorporated herein by reference to Exhibit 3.4 to Form S-4 (File No. 333-193951) filed with the Securities and Exchange Commission on February 14, 2014).</u></a>

- 3.5 [Articles of Amendment to the Charter Designating Senior Non-Cumulative Perpetual Preferred Stock, Series A of Franklin Financial Network, Inc., dated September 26, 2011 \(incorporated herein by reference to Exhibit 3.5 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 3.6 [Articles of Amendment to the Charter of Franklin Financial Network, Inc., dated March 10, 2015 \(incorporated herein by reference to Exhibit 3.6 to Form 10-K \(File No. 333-193951\) filed with the Securities and Exchange Commission on March 11, 2015\).](#)
- 3.7 [Articles of Amendment to the Charter of Franklin Financial Network, Inc., dated May 25, 2017 \(incorporated herein by reference to Exhibit 3.1 to Form 10-Q \(File No. 001-36895\) filed with the Securities and Exchange Commission on August 9, 2017\).](#)
- 3.8 [Amended and Restated Bylaws of Franklin Financial Network, Inc. \(incorporated herein by reference to Exhibit 3.7 to Form 10-K \(File No. 333-193951\) filed with the Securities and Exchange Commission on March 11, 2015\).](#)
- 4.1 [Specimen Stock Certificate of Franklin Financial Network, Inc. \(incorporated herein by reference to Exhibit 4.1 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 4.2 See Exhibits 3.1 through 3.4 and Exhibits 3.6 through 3.8 for provisions of the Charter and Bylaws defining rights of holders of the Registrant's Common Stock.
- 4.3 [Indenture, dated March 31, 2016, by and between Franklin Financial Network, Inc. and U.S. Bank National Association, as Trustee \(incorporated herein by reference to Exhibit 4.1 to Form 8-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on March 31, 2016\).](#)
- 4.4 [First Supplemental Indenture, dated March 31, 2016, by and between Franklin Financial Network, Inc. and U.S. Bank National Association, as Trustee \(incorporated herein by reference to Exhibit 4.2 to Form 8-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on March 31, 2016\).](#)
- 4.5 [Global Note representing Franklin Financial Network, Inc.'s Fixed-to-Floating Rate Subordinated Notes due 2026 \(incorporated herein by reference to Exhibit 4.3 to Form 8-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on March 31, 2016\).](#)
- 4.6 [Form of 7.00% Fixed-to-Floating Rate Subordinated Note Due 2026 \(incorporated herein by reference to Exhibit 4.1 to Form 8-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on June 30, 2016\).](#)
- 4.7 [Form of Lock-Up Agreement between Franklin Financial Network, Inc. and certain Directors of Civic Bank & Trust \(incorporated herein by reference to Exhibit 4.7 to Amendment No. 1 to Form S-4 \(File No. 333-209527\) filed with the Securities and Exchange Commission on January 24, 2018\).](#)
- 10.1 [Retail Lease Agreement, dated as of December 21, 2011 by and between Westhaven Town Center Fund I, LLC and Franklin Synergy Bank \(incorporated herein by reference to Exhibit 10.1 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.2 [Triple Net Office Lease Agreement, dated as of June 12, 2012 by and between Berry Farms Real Estate Partners, LLC and Franklin Synergy Bank \(incorporated herein by reference to Exhibit 10.2 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.3 [Lease Agreement, dated as of December 12, 2012 by and between First Farmers and Merchants Bank and Franklin Synergy Bank \(incorporated herein by reference to Exhibit 10.3 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.4 [First Amendment to Lease Agreement, dated as of February 1, 2016 by and between Overlook Center, LLC as successor in interest to First Farmers and Merchants Bank and Franklin Synergy Bank \(incorporated herein by reference to Exhibit 10.4 to Form 10-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on March 15, 2016\).](#)
- 10.5 [Office Lease Agreement, dated as of May 11, 2007 by and between PCC Investments II, LLC and Franklin Financial Network, Inc. \(Aspen Brook Village Suites 201, 202 and 203\) \(incorporated herein by reference to Exhibit 10.4 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)

- 10.6 [Triple Net Office Lease Agreement, dated as of May 4, 2010 by and between Columbia Avenue Partners, LLC and Franklin Synergy Bank \(incorporated herein by reference to Exhibit 10.5 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.7 [Amendment to Triple Net Lease Agreement, dated as of January 12, 2016 by and between Columbia Avenue Partners, LLC and Franklin Synergy Bank \(incorporated herein by reference to Exhibit 10.7 to Form 10-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on March 15, 2016\).](#)
- 10.8 [Lease, dated as of May 21, 2012 by and between CHHM Properties and Franklin Synergy Bank \(incorporated herein by reference to Exhibit 10.6 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.9 [Lease Agreement, effective October 8, 2008 by and between UCM/ProVenture-Synergy Business Park, LLC and Franklin Synergy Bank \(incorporated herein by reference to Exhibit 10.12 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.10 [Lease Amendment No. 1, dated as of June 11, 2013 by and between Mooreland Investors, LP, successor in interest to UCM/ProVenture-Synergy Business Park, LLC, and Franklin Synergy Bank \(incorporated herein by reference to Exhibit 10.13 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.11 [Office Lease Agreement, dated as of May 11, 2007 by and between PCC Investments II, LLC and Franklin Financial Network, Inc. \(Aspen Brook Village Suites 106, 107 and 108\) \(incorporated herein by reference to Exhibit 10.14 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.12 [Lease dated as of April 20, 2010 by and between Edwin B. Raskin Company, as agent for SIG, LLC, and Franklin Synergy Bank \(incorporated herein by reference to Exhibit 10.15 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.13\* [Form of Franklin Financial Network, Inc.'s Organizers' Warrant Agreement \(incorporated herein by reference to Exhibit 10.16 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.14\* [Form of Franklin Financial Network, Inc. Award Agreement for Non-Qualified Stock Options \(incorporated herein by reference to Exhibit 10.49 to Form S-4/A \(File No. 333-193951\) filed with the Securities and Exchange Commission on April 29, 2014\).](#)
- 10.15\* [Form of Franklin Financial Network, Inc. Award Agreement for Restricted Stock \(incorporated herein by reference to Exhibit 10.50 to Form S-4/A \(File No. 333-193951\) filed with the Securities and Exchange Commission on April 29, 2014\).](#)
- 10.16\* [Form of Franklin Financial Network, Inc. Award Agreement for Incentive Stock Options \(incorporated herein by reference to Exhibit 10.51 to Form S-4/A \(File No. 333-193951\) filed with the Securities and Exchange Commission on April 29, 2014\).](#)
- 10.17\* [Employment Agreement, dated as of January 29, 2014 by and between Franklin Synergy Bank and Richard E. Herrington \(incorporated herein by reference to Exhibit 10.17 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.18\* [Employment Agreement, dated as of January 29, 2014 by and between Franklin Synergy Bank and Kevin A. Herrington \(incorporated herein by reference to Exhibit 10.18 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.19\* [Employment Agreement, dated as of January 29, 2014 by and between Franklin Synergy Bank and Sally E. Bowers \(incorporated herein by reference to Exhibit 10.19 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.20\* [Employment Agreement, dated as of January 29, 2014 by and between Franklin Synergy Bank and Ashley P. Hill, III \(incorporated herein by reference to Exhibit 10.20 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.21\* [Employment Agreement, dated as of January 29, 2014 by and between Franklin Synergy Bank and J. Myers Jones, III \(incorporated herein by reference to Exhibit 10.21 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.22\* [Employment Agreement, dated as of January 29, 2014 by and between Franklin Synergy Bank and David J. McDaniel \(incorporated herein by reference to Exhibit 10.22 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)

- 10.23\* [Employment Agreement dated as of January 29, 2014 by and between Franklin Synergy Bank and Sally P. Kimble \(incorporated herein by reference to Exhibit 10.23 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.24\* [Form of Employment Agreement by and between Franklin Financial Network, Inc. and Sarah Meyerrose \(incorporated herein by reference to Exhibit 10.1 to Form 8-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on June 21, 2016\).](#)
- 10.25\* [Confidentiality, Non-Competition Agreement and Non-Solicitation Agreement, dated as of January 29, 2014 by and between Franklin Synergy Bank and Richard E. Herrington \(incorporated herein by reference to Exhibit 10.24 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.26\* [Confidentiality, Non-Competition Agreement and Non-Solicitation Agreement, dated as of January 29, 2014 by and between Franklin Synergy Bank and Kevin A. Herrington \(incorporated herein by reference to Exhibit 10.25 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.27\* [Confidentiality, Non-Competition Agreement and Non-Solicitation Agreement, dated as of January 29, 2014 by and between Franklin Synergy Bank and Sally E. Bowers \(incorporated herein by reference to Exhibit 10.26 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.28\* [Confidentiality, Non-Competition Agreement and Non-Solicitation Agreement, dated as of January 29, 2014 by and between Franklin Synergy Bank and Ashley P. Hill, III \(incorporated herein by reference to Exhibit 10.27 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.29\* [Confidentiality, Non-Competition Agreement and Non-Solicitation Agreement, dated as of January 29, 2014 by and between Franklin Synergy Bank and J. Myers Jones, III \(incorporated herein by reference to Exhibit 10.28 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.30\* [Confidentiality, Non-Competition Agreement and Non-Solicitation Agreement, dated as of January 29, 2014 by and between Franklin Synergy Bank and David J. McDaniel \(incorporated herein by reference to Exhibit 10.29 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.31\* [Confidentiality, Non-Competition Agreement and Non-Solicitation Agreement, dated as of January 29, 2014 by and between Franklin Synergy Bank and Sally P. Kimble \(incorporated herein by reference to Exhibit 10.30 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.32\* [Form of Confidentiality, Non-Competition Agreement and Non-Solicitation Agreement by and between Franklin Financial Network, Inc. and Sarah Meyerrose \(incorporated herein by reference to Exhibit 10.2 to Form 8-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on June 21, 2016\).](#)
- 10.33\* [Form of Lee M. Moss Employment Agreement \(incorporated herein by reference to Exhibit 10.34 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.34\* [Form of Lee M. Moss Confidentiality, Non-Competition Agreement and Non-Solicitation Agreement \(incorporated herein by reference to Exhibit 10.35 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.35\* [Form of Lee M. Moss Retention Bonus Agreement \(incorporated herein by reference to Exhibit 10.36 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.36\* [Form of Kevin D. Busbey Employment Agreement \(incorporated herein by reference to Exhibit 10.37 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.37\* [Form of Kevin D. Busbey Confidentiality, Non-Competition Agreement and Non-Solicitation Agreement \(incorporated herein by reference to Exhibit 10.38 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.38\* [Form of Kevin D. Busbey Retention Bonus Agreement \(incorporated herein by reference to Exhibit 10.39 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)



- 10.39\* [Form of Dallas G. Caudle, Jr. Employment Agreement \(incorporated herein by reference to Exhibit 10.40 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.40\* [Form of Dallas G. Caudle, Jr. Confidentiality, Non-Competition Agreement and Non-Solicitation Agreement \(incorporated herein by reference to Exhibit 10.41 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.41\* [Form of Dallas G. Caudle, Jr. Retention Bonus Agreement \(incorporated herein by reference to Exhibit 10.42 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.42\* [Form of D. Edwin Jernigan, Jr. Retention Bonus Agreement \(incorporated herein by reference to Exhibit 10.43 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.43\* [Form of D. Edwin Jernigan, Jr. Stock Option Award Agreement \(incorporated herein by reference to Exhibit 10.44 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.44\* [Franklin Financial Network, Inc. 2007 Omnibus Equity Incentive Plan \(incorporated herein by reference to Exhibit 10.45 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.45\* [Franklin Financial Network, Inc. 2017 Omnibus Equity Incentive Plan \(incorporated by reference to Appendix B to Definitive Proxy Statement on Schedule 14A \(File No. 001-36895\) filed with the Securities and Exchange Commission on April 14, 2017\).](#)
- 10.46 [Form of Split Dollar Life Insurance Agreement \(incorporated herein by reference to Exhibit 10.48 to Form S-4 \(File No. 333-193951\) filed with the Securities and Exchange Commission on February 14, 2014\).](#)
- 10.47 [Contract for Sale of Real Estate, dated as of December 5, 2014 by and between Franklin Synergy Bank and Murfreesboro Branches, LLC \(incorporated herein by reference to Exhibit 10.1 to Form 8-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on December 11, 2014\).](#)
- 10.48 [Triple Net Office Lease Agreement, dated as of December 5, 2014 by and between Murfreesboro Branches, LLC and Franklin Synergy Bank \(incorporated herein by reference to Exhibit 10.2 to Form 8-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on December 11, 2014\).](#)
- 10.49 [Triple Net Office Lease Agreement, dated as of December 5, 2014 by and between Murfreesboro Branches, LLC and Franklin Synergy Bank \(incorporated herein by reference to Exhibit 10.3 to Form 8-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on December 11, 2014\).](#)
- 10.50 [Triple Net Office Lease Agreement, dated as of December 5, 2014 by and between Murfreesboro Branches, LLC and Franklin Synergy Bank \(incorporated herein by reference to Exhibit 10.4 to Form 8-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on December 11, 2014\).](#)
- 10.51 [Asset Purchase and Sale Agreement, by and between BCG Consulting, LLC, Banc Compliance Group, Inc. and Franklin Financial Network, Inc. \(incorporated herein by reference to Exhibit 10.1 to Form 8-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on January 2, 2015\).](#)
- 10.52 [Triple Net Office Lease Agreement, dated as of February 19, 2015 by and between Murfreesboro Branches, LLC and Franklin Synergy Bank, for the property located at 2610 Old Fort Parkway, Murfreesboro, Tennessee \(incorporated herein by reference to Exhibit 10.1 to Form 8-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on February 25, 2015\).](#)
- 10.53 [Triple Net Office Lease Agreement, dated as of February 19, 2015 by and between Murfreesboro Branches, LLC and Franklin Synergy Bank, for the property located at 724 President Place, Smyrna, Tennessee \(incorporated herein by reference to Exhibit 10.2 to Form 8-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on February 25, 2015\).](#)
- 10.54 [Triple Net Office Lease Agreement, dated as of February 19, 2015 by and between Murfreesboro Branches, LLC and Franklin Synergy Bank, for the property located at 2782 South Church Street, Murfreesboro, Tennessee \(incorporated herein by reference to Exhibit 10.3 to Form 8-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on February 25, 2015\).](#)

- 10.55 [Triple Net Office Lease Agreement, dated as of June 11, 2015 by and between Columbia Avenue Partners, LLC and Franklin Synergy Bank \(incorporated herein by reference to Exhibit 10.1 to Form 8-K \(File No. 001-36895\) filed with the Commission on June 12, 2015\).](#)
- 10.56 [Lease Agreement, by and between The Grandview Eight, L.L.C. and Franklin Synergy Bank \(incorporated herein by reference to Exhibit 10.1 to Form 8-K \(File No. 001-36895\) filed with the Commission on July 29, 2015\).](#)
- 10.57 [Standard Form of Agreement Between Owner and Contractor, by and between Franklin Synergy Bank and Century Skanska \(incorporated herein by reference to Exhibit 10.1 to Form 8-K \(File No. 001-36895\) filed with the Commission on September 29, 2015\).](#)
- 10.58 [Standard Form of Agreement Between Owner and Contractor, by and between Franklin Synergy Bank and Century Skanska \(incorporated herein by reference to Exhibit 10.1 to Form 8-K \(File No. 001-36895\) filed with the Securities Exchange Commission on October 13, 2015\).](#)
- 10.59 [Amendment to the Contract \(incorporated herein by reference to Exhibit 10.2 to Form 8-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on October 13, 2015\).](#)
- 10.60 [Amendment to the Contract, by and between Franklin Synergy Bank and Century Skanska \(incorporated herein by reference to Exhibit 10.57 to Form 10-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on March 15, 2016\).](#)
- 10.61 [Standard Form of Agreement Between Owner and Contractor, by and between Franklin Synergy Bank and Century Skanska \(incorporated herein by reference to Exhibit 10.1 to Form 8-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on July 13, 2016\).](#)
- 10.62 [Amendment to Triple Net Office Lease Agreement, dated as of January 12, 2016 by and between Columbia Avenue Partners, LLC and Franklin Synergy Bank \(incorporated herein by reference to Exhibit 10.59 to Form 10-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on March 15, 2016\).](#)
- 10.63 [Amendment to Triple Net Office Lease Agreement, dated as of January 12, 2016 by and between Columbia Avenue Partners, LLC and Franklin Synergy Bank \(incorporated herein by reference to Exhibit 10.60 to Form 10-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on March 15, 2016\).](#)
- 10.64 [Triple Net Office Lease Agreement, by and between Gateway Real Estate Partners, LLC and Franklin Synergy Bank \(incorporated herein by reference to Exhibit 10.1 to Form 8-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on April 4, 2016\).](#)
- 10.65 [Commencement Agreement, dated May 15, 2017 \(incorporated herein by reference to Exhibit 10.1 to Form 10-Q \(File No. 001-36895\) filed with the Securities and Exchange Commission on August 9, 2017\).](#)
- 10.66 [Form of Subordinated Note Purchase Agreement, dated as of June 30, 2016, by and among Franklin Financial Network, Inc. and the several purchasers identified therein \(incorporated herein by reference to Exhibit 10.1 to Form 8-K \(File No. 001-36895\) filed with the Securities and Exchange Commission on June 30, 2016\).](#)
- 10.67 [Triple Net Office Lease Agreement, by and between Petra Real Estate Partners II, LLC and Franklin Synergy Bank \(incorporated by reference to Exhibit 10.1 to Form 8-K filed with the Securities and Exchange Commission on July 27, 2017\).](#)
- 10.68 [Lease Agreement, by and between SS McEwen, LLC and Franklin Synergy Bank \(incorporated by reference to Exhibit 10.2 to Form 8-K filed with the Securities and Exchange Commission on July 27, 2017\).](#)
- 21.1† [Subsidiaries of the Registrant.](#)
- 23.1† [Consent of Crowe Horwath LLP.](#)
- 31.1† [Certification of CEO pursuant to Rules 13a-14\(a\) of the Securities Exchange Act of 1934.](#)
- 31.2† [Certification of CFO pursuant to Rules 13a-14\(a\) of the Securities Exchange Act of 1934.](#)
- 32†† [Certification Pursuant to 18 U.S.C. Section 1350.](#)

101† The following financial information from Franklin Financial Network, Inc.'s Annual Report on Form 10-K for the period ended December 31, 2017, filed with the SEC on March 16, 2018, formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Balance Sheet as of December 31, 2017 and December 31, 2016; (ii) the Consolidated Statements of Income for the years ended December 31, 2017, 2016 and 2015; (iii) the Consolidated Statements of Comprehensive Income for the years ended December 31, 2017, 2016 and 2015; (iv) the Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2017, 2016 and 2015; (v) the Consolidated Statements of Cash Flows for the years ended December 31, 2017, 2016 and 2015; and (vi) Notes to Consolidated Financial Statements.

† Filed herewith.

†† Furnished herewith.

\* Indicates a management contract or compensatory plan or arrangement.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

March 16, 2018

FRANKLIN FINANCIAL NETWORK, INC.

By: /s/ Richard E. Herrington

Richard E. Herrington  
Chief Executive Officer and Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacity and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Richard E. Herrington</u> Richard E. Herrington	Chairman, President & CEO (Principal Executive Officer)	March 14, 2018
<u>/s/ Sarah Meyerrose</u> Sarah Meyerrose	Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 12, 2018
<u>/s/ Jimmy E. Allen</u> Jimmy E. Allen	Director	March 14, 2018
<u>/s/ James W. Cross, IV</u> James W. Cross, IV	Director	March 14, 2018
<u>Paul M. Pratt, Jr.</u>	Director	
<u>/s/ Pamela J. Stephens</u> Pamela J. Stephens	Director	March 12, 2018
<u>Melody J. Sullivan</u>	Director	
<u>/s/ Gregory E. Waldron</u> Gregory E. Waldron	Director	March 14, 2018
<u>/s/ Benjamin Wynd</u> Benjamin Wynd	Director	March 12, 2018

## INDEX TO FINANCIAL STATEMENTS

The following financial statements are included in Part II, Item 8:

	<u>Page</u>
<a href="#"><u>Report of Independent Registered Public Accounting Firm</u></a>	F-2
<a href="#"><u>Consolidated Balance Sheets – December 31, 2017 and 2016</u></a>	F-3
<a href="#"><u>Consolidated Statements of Income – Years ended December 31, 2017, 2016 and 2015</u></a>	F-4
<a href="#"><u>Consolidated Statements of Comprehensive Income – Years ended December 31, 2017, 2016 and 2015</u></a>	F-5
<a href="#"><u>Consolidated Statements of Changes in Equity – Years ended December 31, 2017, 2016 and 2015</u></a>	F-6
<a href="#"><u>Consolidated Statements of Cash Flows – Years ended December 31, 2017, 2016 and 2015</u></a>	F-8
<a href="#"><u>Notes to Consolidated Financial Statements</u></a>	F-10



Report of Independent Registered Public Accounting Firm

Shareholders and the Board of Directors  
Franklin Financial Network, Inc.  
Franklin, Tennessee

**Opinion on the Financial Statements**

We have audited the accompanying consolidated balance sheets of Franklin Financial Network, Inc. (the “Company”) as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for each of the three years in the period ended December 31, 2017, and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

**Basis for Opinion**

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting in accordance with the standards of the PCAOB. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion in accordance with the standards of the PCAOB.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Crowe Horwath LLP

We have served as the Company’s auditor since 2007.

Franklin, Tennessee  
March 16, 2018

**FRANKLIN FINANCIAL NETWORK, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**December 31, 2017 and 2016**

*(Dollar amounts in thousands, except share and per share data)*

	<b>2017</b>	<b>2016</b>
<b>ASSETS</b>		
Cash and due from financial institutions	\$ 251,543	\$ 90,927
Certificates of deposit at other financial institutions	2,855	1,055
Securities available for sale	999,881	754,755
Securities held to maturity (fair value 2017—\$217,608 and 2016—\$227,892)	214,856	228,894
Loans held for sale, at fair value	12,024	23,699
Loans	2,256,608	1,773,592
Allowance for loan losses	(21,247)	(16,553)
Net loans	2,235,361	1,757,039
Restricted equity securities, at cost	18,492	11,843
Premises and equipment, net	11,281	9,551
Accrued interest receivable	11,947	9,931
Bank owned life insurance	49,085	23,267
Deferred tax asset	10,007	15,013
Foreclosed assets	1,503	—
Servicing rights, net	3,620	3,621
Goodwill	9,124	9,124
Core deposit intangible, net	1,007	1,480
Other assets	10,940	2,990
Total assets	\$3,843,526	\$2,943,189
<b>LIABILITIES AND EQUITY</b>		
Deposits		
Non-interest bearing	\$ 272,172	\$ 233,781
Interest bearing	2,895,056	2,158,037
Total deposits	3,167,228	2,391,818
Federal funds purchased and repurchase agreements	31,004	83,301
Federal Home Loan Bank advances	272,000	132,000
Subordinated notes, net	58,515	58,337
Accrued interest payable	2,769	1,924
Other liabilities	7,357	5,448
Total liabilities	3,538,873	2,672,828
Equity		
Preferred stock, no par value: 1,000,000 shares authorized; Senior non-cumulative preferred stock, no par value, \$10,000 liquidation value: Series A, 10,000 shares authorized; no shares outstanding at December 31, 2017 and December 31, 2016	—	—
Common stock, no par value: 30,000,000 and 20,000,000 shares authorized at December 31, 2017 and 2016, respectively; 13,237,128 and 13,036,954 issued at December 31, 2017 and 2016, respectively	222,665	218,354
Retained earnings	88,671	59,386
Accumulated other comprehensive loss	(6,786)	(7,482)
Total shareholders' equity	304,550	270,258
Noncontrolling interest in consolidated subsidiary	103	103
Total equity	\$ 304,653	\$ 270,361
Total liabilities and equity	\$3,843,526	\$2,943,189

See accompanying notes to consolidated financial statements.

**FRANKLIN FINANCIAL NETWORK, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**Years ended December 31, 2017, 2016 and 2015**  
*(Dollar amounts in thousands, except share and per share data)*

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Interest income and dividends			
Loans, including fees	\$100,470	\$78,236	\$53,574
Securities:			
Taxable	21,309	15,306	12,362
Tax-exempt	8,593	5,609	2,331
Dividends on restricted equity securities	928	500	350
Federal funds sold and other	1,153	256	104
Total interest income	<u>132,453</u>	<u>99,907</u>	<u>68,721</u>
Interest expense			
Deposits	27,464	14,234	8,688
Federal funds purchased and repurchase agreements	407	303	306
Federal Home Loan Bank advances	3,215	884	312
Subordinated notes and other borrowings	4,321	2,902	—
Total interest expense	<u>35,407</u>	<u>18,323</u>	<u>9,306</u>
Net interest income	97,046	81,584	59,415
Provision for loan losses	4,313	5,240	5,030
Net interest income after provision for loan losses	<u>92,733</u>	<u>76,344</u>	<u>54,385</u>
Noninterest income			
Service charges on deposit accounts	154	185	113
Other service charges and fees	3,041	3,041	2,644
Net gain on sale of loans	6,779	7,183	6,959
Wealth management	2,577	1,894	1,283
Loan servicing fees, net	336	22	227
Gain on sales and calls of securities	896	2,172	833
Net gain (loss) on foreclosed assets	(7)	40	26
Other	945	603	771
Total noninterest income	<u>14,721</u>	<u>15,140</u>	<u>12,856</u>
Noninterest expense			
Salaries and employee benefits	35,268	30,029	24,040
Occupancy and equipment	9,219	7,627	6,589
FDIC assessment expense	3,680	2,068	1,167
Marketing	965	762	956
Professional fees	3,395	3,546	2,425
Other	8,297	7,649	6,963
Total noninterest expense	<u>60,824</u>	<u>51,681</u>	<u>42,140</u>
Income before income tax expense	46,630	39,803	25,101
Income tax expense	18,531	11,746	9,021
Net income	28,099	28,057	\$16,080
Dividends paid on Series A preferred stock	—	(23)	(100)
Earnings attributable to noncontrolling interest	(16)	—	—
Net income available to common shareholders	<u>\$ 28,083</u>	<u>\$28,034</u>	<u>\$15,980</u>
Earnings per share:			
Basic	\$ 2.14	\$ 2.56	\$ 1.62
Diluted	2.04	2.42	1.54

See accompanying notes to consolidated financial statements.



**FRANKLIN FINANCIAL NETWORK, INC.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**Years ended December 31, 2017, 2016 and 2015**  
*(Dollar amounts in thousands, except share and per share data)*

	<b>2017</b>	<b>2016</b>	<b>2015</b>
Net income	\$28,099	\$ 28,057	\$16,080
Other comprehensive income (loss), net of tax:			
Unrealized gains/losses on securities:			
Unrealized holding gain (loss) arising during the period	4,015	(9,609)	(3,220)
Reclassification adjustment for gains on sales, calls, and prepayments of securities included in net income	(896)	(2,172)	(833)
Net unrealized gains (losses)	3,119	(11,781)	(4,053)
Tax effect, includes \$351, \$852, and \$327, respectively, income tax expense from gains on sales of securities	(1,221)	4,619	1,557
Total other comprehensive income (loss)	1,898	(7,162)	(2,496)
Comprehensive income	\$29,997	\$ 20,895	\$13,584

NOTE: No other comprehensive income is allocated to noncontrolling interest.

See accompanying notes to consolidated financial statements.

**FRANKLIN FINANCIAL NETWORK, INC.**  
**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**  
**Years ended December 31, 2017, 2016 and 2015**  
*(Dollar amounts in thousands, except share and per share data)*

	Preferred Stock	Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest	Total Equity
	Shares	Amount	Earnings	Income (Loss)	Interest	Equity	
Balance at December 31, 2014	\$ 10,000	7,756,411	\$ 94,251	\$15,372	\$ 2,176	\$ —	\$121,799
Exercise of common stock options, includes net settlement of shares	—	125,478	1,301	—	—	—	1,301
Exercise of common stock warrants	—	6,570	79	—	—	—	79
Dividends paid on Series A preferred stock	—	—	—	(100)	—	—	(100)
Issuance of restricted stock, net of forfeitures	—	28,229	—	—	—	—	—
Stock based compensation expense, net of forfeitures	—	—	860	—	—	—	860
Stock issued related to initial public offering, net of stock issuance costs of \$5,017	—	2,640,000	50,423	—	—	—	50,423
Stock issued in conjunction with 401(k) employer match, net of distributions	—	14,689	337	—	—	—	337
Excess tax benefit from exercise of stock options and vesting of restricted shares	—	—	533	—	—	—	533
Net income	—	—	—	16,080	—	—	16,080
Other comprehensive income	—	—	—	—	(2,496)	—	(2,496)
Balance at December 31, 2015	\$ 10,000	10,571,377	\$147,784	\$31,352	\$ (320)	\$ —	\$188,816
Exercise of common stock options, includes net settlement of shares	—	190,389	1,571	—	—	—	1,571
Exercise of common stock warrants	—	8,450	101	—	—	—	101
Redemption of Series A preferred stock	(10,000)	—	—	—	—	—	(10,000)
Dividends paid on Series A preferred stock	—	—	—	(23)	—	—	(23)
Issuance of restricted stock, net of forfeitures	—	34,001	—	—	—	—	—
Stock based compensation expense, net of forfeitures	—	—	1,641	—	—	—	1,641
Stock issued related to public offering, net of stock issuance costs of \$4,203	—	2,242,500	67,557	—	—	—	67,557
Stock issued in conjunction with 401(k) employer match, net of distributions	—	(9,763)	(300)	—	—	—	(300)
Issuance of preferred stock of consolidated subsidiary to noncontrolling interest, net of issuance costs	—	—	—	—	—	103	103
Net income	—	—	—	28,057	—	—	28,057
Other comprehensive loss	—	—	—	—	(7,162)	—	(7,162)
Balance at December 31, 2016	\$ —	13,036,954	\$218,354	\$59,386	\$ (7,482)	\$ 103	\$270,361
Exercise of common stock options, includes net settlement of shares	—	166,894	1,615	—	—	—	1,615
Exercise of common stock warrants	—	12,461	150	—	—	—	150
Issuance of restricted stock, net of forfeitures	—	26,718	—	—	—	—	—

	Preferred Stock	Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest	Total Equity
		Shares	Amount				
Stock based compensation expense, net of forfeitures	—	—	2,802	—	—	—	2,802
Stock issued in conjunction with 401(k) employer match, net of distributions	—	(5,899)	(256)	—	—	—	(256)
Earnings attributable to noncontrolling interest	—	—	—	—	—	16	16
Net income available to common shareholders	—	—	—	28,083	—	—	28,083
Noncontrolling interest distributions	—	—	—	—	—	(16)	(16)
Reclassification of disproportionate tax effect (Note 1)	—	—	—	1,202	(1,202)	—	—
Other comprehensive income	—	—	—	—	1,898	—	1,898
Balance at December 31, 2017	<u>\$ —</u>	<u>13,237,128</u>	<u>\$222,665</u>	<u>\$88,671</u>	<u>\$ (6,786)</u>	<u>\$ 103</u>	<u>\$304,653</u>

See accompanying notes to consolidated financial statements.

**FRANKLIN FINANCIAL NETWORK, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**Years ended December 31, 2017, 2016 and 2015**  
*(Dollar amounts in thousands, except share and per share data)*

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Cash flows from operating activities</b>			
Net income	\$ 28,099	\$ 28,057	\$ 16,080
Adjustments to reconcile net income to net cash from operating activities			
Depreciation and amortization on premises and equipment	1,482	1,330	1,325
Accretion of purchase accounting adjustments	(1,078)	(1,175)	(1,897)
Net amortization of securities	10,129	7,673	4,961
Amortization of loan servicing right asset	934	1,201	909
Amortization of core deposit intangible	473	563	655
Amortization of debt issuance costs	178	124	—
Provision for loan losses	4,313	5,240	5,030
Deferred income tax (benefit)	3,785	(964)	(1,058)
Excess tax benefit related to the exercise of stock options	—	(1,013)	(533)
Origination of loans held for sale	(357,983)	(371,173)	(301,190)
Proceeds from sale of loans held for sale	378,243	367,369	312,150
Net gain on sale of loans	(6,779)	(7,183)	(6,959)
Gain on sale of available for sale securities	(896)	(2,172)	(684)
Gain on call of held to maturity securities	—	—	(149)
Income from bank owned life insurance	(818)	(648)	(611)
(Gain) loss on sale of foreclosed assets	20	(28)	(16)
Loss on sale of assets held for sale	—	98	—
Stock-based compensation	2,802	1,641	860
Compensation expense related to common stock issued to 401(k) plan	—	—	466
Recognition of deferred gain on sale of loans	(58)	(64)	(36)
Recognition of deferred gain on sale of foreclosed assets	(14)	(12)	(10)
Net change in:			
Accrued interest receivable and other assets	(10,020)	(2,278)	(5,599)
Accrued interest payable and other liabilities	2,826	1,610	3,584
Net cash from operating activities	<u>55,638</u>	<u>28,196</u>	<u>27,278</u>
<b>Cash flows from investing activities</b>			
Available for sale securities:			
Sales	240,175	93,873	107,300
Purchases	(664,894)	(391,036)	(498,977)
Maturities, prepayments and calls	175,457	103,307	204,147
Held to maturity securities:			
Purchases	(4,266)	(94,749)	(116,322)
Maturities, prepayments and calls	16,326	21,712	10,670
Net change in loans	(487,060)	(468,973)	(515,837)
Purchase of bank owned life insurance	(25,000)	—	(10,344)
Proceeds from sale of buildings held for sale	—	1,542	4,080
Purchase of restricted equity securities	(6,649)	(3,845)	(2,649)
Proceeds from sale of foreclosed assets	1,330	336	531
Purchases of premises and equipment, net	(3,212)	(3,241)	(941)
Increase in certificates of deposits at other financial institutions	(1,800)	(805)	—
Capitalization of foreclosed assets	(35)	—	—
Net cash from investing activities	<u>(759,628)</u>	<u>(741,879)</u>	<u>(818,342)</u>

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Cash flows from financing activities</b>			
Increase in deposits	775,410	577,779	641,867
Increase (decrease) in federal funds purchased and repurchase agreements	(52,297)	(17,785)	62,008
Proceeds from Federal Home Loan Bank advances	380,000	325,000	157,000
Repayment of Federal Home Loan Bank advances	(240,000)	(250,000)	(119,000)
Proceeds from other borrowings	—	10,000	—
Repayment of other borrowings	—	(10,000)	—
Proceeds from issuance of subordinated notes, net of issuance costs	—	58,213	—
Proceeds from exercise of common stock warrants	150	101	79
Proceeds from exercise of common stock options	1,615	1,571	1,834
Proceeds from issuance of common stock, net of offering costs	—	67,557	50,423
Divestment of common stock issued to 401(k) plan	(256)	(300)	—
Redemption of Series A preferred stock	—	(10,000)	—
Dividends paid on preferred stock	—	(23)	(100)
Noncontrolling interest distributions	(16)	—	—
Proceeds from issuance of preferred stock of consolidated subsidiary to noncontrolling interest, net of issuance costs	—	103	—
Net cash from financing activities	<u>864,606</u>	<u>752,216</u>	<u>794,111</u>
Net change in cash and cash equivalents	160,616	38,533	3,047
Cash and cash equivalents at beginning of period	90,927	52,394	49,347
Cash and cash equivalents at end of period	\$ 251,543	\$ 90,927	\$ 52,394
Supplemental information:			
Interest paid	\$ 34,562	\$ 17,043	\$ 9,083
Income taxes paid	15,680	14,023	9,738
Non-cash supplemental information:			
Transfers from loans to foreclosed assets	\$ 2,818	\$ 108	\$ —
Transfers from premises and equipment to assets held for sale	—	—	1,640

See accompanying notes to consolidated financial statements.

**FRANKLIN FINANCIAL NETWORK, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
*(Dollar amounts in thousands, except share and per share data)*

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Nature of Operations and Principles of Consolidation: The consolidated financial statements include Franklin Financial Network, Inc. and its wholly-owned subsidiaries, Franklin Synergy Bank (the “Bank”) and Franklin Synergy Risk Management, Inc., together referred to as “the Company.” Intercompany transactions and balances are eliminated in consolidation.

Franklin Financial Network, Inc. was incorporated under the laws of the State of Tennessee on April 5, 2007. Franklin Synergy Bank was incorporated under the laws of the State of Tennessee and received its Certificate of Authority from the Tennessee Department of Financial Institutions and approval of FDIC insurance on November 2, 2007. Franklin Synergy Bank is also a Federal Reserve member bank.

The Company provides financial services through its offices in Franklin, Brentwood, Spring Hill, Murfreesboro, Nashville, Nolensville, and Smyrna, Tennessee. Its primary deposit products are checking, savings, and certificate of deposit accounts, and its primary lending products are commercial and residential construction, commercial, installment loans and lines secured by home equity. Substantially all loans are secured by specific items of collateral including commercial and residential real estate, business assets, and consumer assets. Commercial loans are expected to be repaid by cash flow from operations of businesses. The Company also focuses on electronic banking products such as internet banking, remote deposit capture and lockbox services.

On December 28, 2015, the Company invested in a wholly-owned subsidiary, Franklin Synergy Risk Management, Inc., which provides risk management services to the Company in the form of enhanced insurance coverages.

On March 1, 2016, the Bank invested in a wholly-owned subsidiary, Franklin Synergy Investments of Tennessee, Inc. (“FSIT”), which provides investment services to the Bank. Also on March 1, 2016, FSIT invested in a wholly-owned subsidiary, Franklin Synergy Investments of Nevada, Inc. (“FSIN”), to provide investment services to FSIT related to certain municipal securities. In addition, on March 1, 2016, FSIN invested in a subsidiary, Franklin Synergy Preferred Capital, Inc., to serve as a real estate investment trust (“REIT”), to allow the Bank to sell real estate loans to obtain a tax benefit. FSIN has a controlling interest in the REIT, but the REIT also has a group of investors that own a noncontrolling interest in the preferred stock of the REIT.

On November 10, 2017, Franklin Financial Network, Inc. issued a press release (the “Press Release”) announcing that it had filed with the Federal Reserve an application for the approval of its previously announced merger with Civic Bank & Trust. The proposed acquisition of Civic by the Company, which was originally announced on December 14, 2015, has been approved by each company’s Board of Directors. The Company received approval of the TDFI on April 13, 2016 and approval of the Federal Reserve Bank (FRB) on December 28, 2017. Completion of the transaction is subject to the approval of Civic’s shareholders and satisfaction of customary closing conditions.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ.

Cash Flows: Cash and cash equivalents include cash, deposits with other financial institutions with maturities under 90 days, and federal funds sold. Net cash flows are reported for customer loan and deposit transactions, interest bearing deposits in other financial institutions and federal funds purchased.

Interest-Bearing Deposits in Financial Institutions: Interest-bearing deposits in other financial institutions are carried at cost.

Securities: Debt securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment (OTTI) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Management assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of these criteria is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. No OTTI has been recognized for the years ended December 31, 2017, 2016 or 2015.

Loans Held for Sale: Loans originated and intended for sale in the secondary market are carried at fair value, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

Certain loans held for sale are sold with servicing rights retained. The carrying value of loans sold with retained servicing is reduced by the amount allocated to the servicing right. Gains and losses on sales of loans are based on the difference between the selling price and the carrying value of the related loan sold.

Loans held for sale, for which the fair value option has been elected, are recorded at fair value as of each balance sheet date. The fair value includes the servicing value of the loans.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of purchase discounts, deferred loan fees and costs, and an allowance for loan losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method without anticipating prepayments.

Interest income on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the loan is well-secured and in process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. A loan is moved to non-accrual status in accordance with the Company's policy, typically after 90 days of non-payment.

All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Concentration of Credit Risk: Most of the Company's business activity is with customers located within Williamson County and Rutherford County; therefore, the Company's exposure to credit risk is significantly affected by changes in the economy in the Williamson County and Rutherford County areas. The Company believes there are no significant concentrations of loans to any one industry or customer. However, the customers' ability to repay their loans is dependent on the real estate and general economic conditions in the area.

Purchased Credit Impaired (PCI) Loans: The Company purchases individual loans and groups of loans, some of which have shown evidence of credit deterioration since origination. These purchased credit impaired loans are recorded at the amount paid, such that there is no carryover of the seller's allowance for loan losses. After acquisition, losses are recognized by an increase in the allowance for loan losses.

Such purchased credit impaired loans are accounted for individually or aggregated into pools of loans based on common risk characteristics such as, credit score, loan type, and date of origination. The Company estimates the amount and timing of expected cash flows for each loan or pool, and the expected cash flows in excess of amount paid is recorded as interest income over the remaining life of the loan or pool (accretable yield). The excess of the loan's or pool's contractual principal and interest over expected cash flows is not recorded (nonaccretable difference).

Over the life of the loan or pool, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded as a provision for loan losses. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

All loans classified by management as substandard or worse are individually evaluated for potential designation as impaired. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

Troubled debt restructurings (TDRs) are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. TDRs are subsequently tracked and reviewed for impairment quarterly. For TDRs that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component covers non-impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on a combination of the Bank's loss history and loss history from the Bank's peer group over the past three years. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The following portfolio segments have been identified:

- Construction and land development loans include loans to finance the process of improving, preparatory or erecting new structures or the on-site construction of industrial, commercial, residential or farm buildings. Construction and land development loans also include loans secured by vacant land, except land known to be used or usable for agricultural purposes. Construction loans generally are made for relatively short terms. They generally are more vulnerable to changes in economic conditions. Further, the nature of these loans is such that they are more difficult to evaluate and monitor. The risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property's value upon completion of the project and the estimated cost (including interest) of the project. Periodic site inspections are made on construction loans.
- Commercial real estate loans include loans secured by non-residential real estate, including farmland and improvements thereon. Often these loans are made to single borrowers or groups of related borrowers, and the repayment of these loans largely depends on the results of operations and management of these properties. Adverse economic conditions may affect the repayment ability of these loans.
- Residential real estate loans include loans secured by residential real estate, including single-family and multi-family dwellings. Mortgage title insurance and hazard insurance are normally required. Adverse economic conditions in the Company's market area may reduce borrowers' ability to repay these loans and may reduce the collateral securing these loans.



- Commercial and industrial loans include loans for commercial, industrial, healthcare or agricultural purposes to business enterprises that are not secured by real estate. Commercial loans are typically made on the basis of the borrower's ability to repay from the cash flow of the borrower's business. Commercial and Agriculture loans are generally secured by accounts receivable, inventory and equipment. The collateral securing loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business.
- Consumer and other loans include loans to individuals for household, family and other personal expenditures that are not secured by real estate. Consumer loans are generally secured by customer deposit accounts, vehicles and other household goods. The collateral securing consumer loans may depreciate over time.

Servicing Rights: When loans are sold with servicing retained, servicing rights are initially recorded at fair value with the income statement effect recorded in gain on sale of loans. Fair value is based on market prices for comparable servicing contracts. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual grouping, to the extent that fair value is less than the carrying amount. If the Company later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase to income. Changes in valuation allowances are reported with loan servicing fees on the income statement. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Servicing fee income, which is reported on the income statement as loan servicing fees, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal; or a fixed amount per loan and are recorded as income when earned. The amortization of mortgage servicing rights is netted against mortgage loan servicing fee income. Late fees and ancillary fees related to loan servicing are not material.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Company, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Foreclosed Assets: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

Premises and Equipment: Premises and equipment are stated at cost less accumulated depreciation and are depreciated using the straight-line method. Depreciation periods are shorter of the asset's useful life or lease period, ranging from three to fifteen years.

Restricted Equity Securities: The Bank is a member of the Federal Reserve Bank (FRB) and the Federal Home Loan Bank (FHLB) system. Members of the FHLB are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. The stock ownership in FRB and FHLB are carried at cost, classified as restricted securities, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Company Owned Life Insurance/Bank Owned Life Insurance: The Company and the Bank have purchased life insurance policies on certain key executives. Company owned life insurance/bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Goodwill and Other Intangible Assets: Goodwill is determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually. The Company has selected December 31 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on the balance sheet.

Other intangible assets consist of core deposit and acquired customer relationship intangible assets arising from whole bank and branch acquisitions are amortized on an accelerated method over their estimated useful lives, which range from 7 to 10 years.

Long-Term Assets: Premises and equipment and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Loan Commitments and Related Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Mortgage Banking Derivatives: Commitments to fund mortgage loans (interest rate locks) to be sold into the secondary market and forward commitments for the future delivery of these mortgage loans are accounted for as free standing derivatives. The fair value of the interest rate lock is recorded at the time the commitment to fund the mortgage loan is executed and is adjusted for the expected exercise of the commitment before the loan is funded. Fair values of these mortgage derivatives are estimated based on changes in mortgage interest rates from the date the interest rate on the loan is locked. The Company enters into forward commitments for the future delivery of mortgage loans when interest rate locks are entered into, in order to hedge the change in interest rates resulting from its commitments to fund the loans. Changes in the fair values of these derivatives are included in net gains on sale of mortgage loans.

Stock-Based Compensation: Compensation cost is recognized for stock options and restricted stock awards issued to employees, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period, reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. Accounting Standards Update ("ASU") 2016-09, "*Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*" requires all excess tax benefits and tax deficiencies related to share-based payment awards to be recognized as income tax expense or benefit in the income statement during the period in which they occur. Prior to the adoption of ASU 2016-09 in the fourth quarter of 2016, these tax benefits were recorded in the statement of stockholders' equity directly to additional paid-in-capital.

Income Taxes: Income tax expense or benefit is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. Accordingly, deferred tax assets that will be realized after December 31, 2017 were revalued using the tax rates enacted as a result of the 2017 Tax Cuts and Jobs Act resulting in a revaluation charge of \$5,323. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

Retirement Plans: Employee 401(k) and profit sharing plan expense is the amount of matching contributions. The matching contributions are paid with employer stock.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale which is recognized as a separate component of equity.

Earnings Per Common Share: Basic earnings per common share is net income available to common shareholders divided by the weighted average number of common shares outstanding during the period. All outstanding unvested share-based payment awards that contain rights to non-forfeitable dividends are considered participating securities for this calculation. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock options and warrants.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

Restrictions on Cash: Cash on hand or on deposit with the Federal Reserve Bank was required to meet regulatory reserve and clearing requirements.

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the bank to the holding company or by the holding company to shareholders.

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Operating Segments: While the chief decision-makers monitor the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Accordingly, all of the financial service operations are considered by management to be aggregated in one reportable operating segment.

Reclassifications: Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or equity.

#### Recently Adopted Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (“FASB”) issued *ASU 2016-09, “Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.”* Under ASU 2016-09 all excess tax benefits and tax deficiencies related to share-based payment awards should be recognized as income tax expense or benefit in the income statement during the period in which they occur. Previously, such amounts were recorded in the pool of excess tax benefits included in additional paid-in capital, if such pool was available. Because excess tax benefits are no longer recognized in additional paid-in capital, the assumed proceeds from applying the treasury stock method when computing earnings per share should exclude the amount of excess tax benefits that would have previously been recognized in additional paid-in capital. Additionally, excess tax benefits should be classified along with other income tax cash flows as an operating activity rather than a financing activity, as was previously the case. ASU 2016-09 also provides that an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest (current Generally Accepted Accounting Principle (“GAAP”)) or account for forfeitures when they occur. ASU 2016-09 changes the threshold to qualify for equity classification (rather than as a liability) to permit withholding up to the maximum statutory tax rates (rather than the minimum as was previously the case) in the applicable jurisdictions. The Company elected to adopt this ASU in the fourth quarter of 2016 effective as of January 1, 2016 and has elected to not account for forfeitures as they occur. The adoption of this ASU decreased income tax expense for the year by \$1,013 and had no impact for 2017.

In February 2018, the FASB issued Accounting Standards Update (“ASU”) 2018-02, *Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.* The amendments in this ASU addressed the income tax accounting treatment of the stranded tax effects within other comprehensive income due to the newly enacted federal corporate tax rate included in the Tax Cuts and Jobs Act issued December 22, 2017. These amendments allow an entity to make a reclassification from other comprehensive income to retained earnings for the difference between the historical corporate income tax rate and the newly enacted corporate income tax rate. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those years. The Company elected to adopt this ASU early. The impact of the new guidance on the Company’s consolidated financial statements was a reclassification of \$1,202 between retained earnings and other comprehensive income at December 31, 2017.

### Recently Issued, Not Yet Effective Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update 2014-09, *Revenue from Contracts with Customers (Topic 606): Revenue from Contracts with Customers*. ASU 2014-09 created a new topic in the FASB Accounting Standards Codification® (“ASC”), Topic 606. In addition to superseding and replacing nearly all existing U.S. GAAP revenue recognition guidance, including industry-specific guidance, ASU 2014-09 established a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, provides new and more detailed guidance on specific topics and expands and improves disclosures about revenue. In addition, ASU 2014-09 added a new Subtopic to the ASC, *Other Assets and Deferred Costs: Contracts with Customers* (“ASC 340-40”), to provide guidance on costs related to obtaining a contract with a customer and costs incurred in fulfilling a contract with a customer that are not in the scope of another ASC Topic. The new guidance does not apply to certain contracts within the scope of other ASC Topics, such as lease contracts, insurance contracts, financing arrangements, financial instruments, guarantees other than product or service warranties, and non-monetary exchanges between entities in the same line of business to facilitate sales to customers. The Company’s sources of non-interest income that fall within the scope of the new standard, such as service charges on deposit accounts, debit card interchange income, wealth management fees, and gain on sale of foreclosed property, are all immaterial in comparison with total revenue and are structured in a way that the non-interest income is not earned over a period of time, which is similar to the treatment under previous revenue recognition standards. The Company adopted ASU 2014-09 and applied the modified retrospective approach with a cumulative effect of initial application in the first quarter of 2018 but there was no impact to retained earnings as a result of the adopting the new standard.

In January 2016, FASB issued ASU 2016-01, *Financial Instruments (Topic 825): Recognition and Measurement of Financial Assets and Financial Liabilities*, which amends prior guidance to require an entity to measure its equity investments (except those accounted for under the equity method of accounting) to be measured at fair value with changes in fair value recognized in net income. An entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment of same issuer. The new guidance simplifies the impairment assessment of equity investments without readily determinable fair values, requires public entities to use the exit price notion when measuring fair value of financial instruments for disclosure purposes, requires an entity to present separately in other comprehensive income the portion of the total change in fair value of a liability resulting from changes in the instrument-specific credit risk when the entity has selected fair value option for financial instruments and requires separate presentation of financial assets and liabilities by measurement category and form of financial asset. ASU 2016-01 was effective for the Company on January 1, 2018 and is not expected to have a significant impact on the Company’s consolidated financial statements and related disclosures.

On February 25, 2016, FASB issued ASU 2016-02 which creates *Topic 842, Leases* and supersedes *Topic 840, Leases*. ASU 2016-02 is intended to improve financial reporting about leasing transactions, by increasing transparency and comparability among organizations. Under the new guidance, a lessee will be required to record all leases with lease terms of more than 12 months on their balance sheet as lease liabilities with a corresponding right-of-use asset. ASU 2016-02 maintains the dual model for lease accounting, requiring leases to be classified as either operating or finance, with lease classification determined in a manner similar to existing lease guidance. The new guidance will be effective for public companies for fiscal years beginning on or after December 15, 2018, and for private companies for fiscal years beginning on or after December 15, 2019. Early adoption is permitted for all entities. At the time this ASU is adopted, the Company will recognize a right-of-use asset and a lease liability for all leases, which will initially be measured at the present value of lease payments, and a single lease cost calculated so that the costs of the leases are allocated over the terms of the Company’s leases on a generally straight-line basis. Since an asset will be recognized at the time of adoption, the Company’s regulatory capital ratios will likely be impacted. This ASU could also impact the reporting of leases as shown in Note 5 - Premises and Equipment and Leases. Management is evaluating the impact ASU 2016-02 will have on the Company’s financial statements.

In June 2016, FASB issued *ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The ASU 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 inform 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. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. The ASU requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The ASU is effective for the Company for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019 (i.e., January 1, 2020, for calendar year entities). Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018; however, the Company does not currently plan to early adopt this ASU. The Company is currently gathering information, reviewing possible vendors and working to determine the methodology to be used. The Company is gathering as much data as possible to enable review scenarios and to determine which calculations will produce the most reliable results. The impact of adopting ASU 2016-13 is not currently known.

In August 2016, FASB issued *ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. This Accounting Standards Update addresses the following eight specific cash flow issues: debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (COLIs) (including bank-owned life insurance policies (BOLIs)); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The amendments in this ASU were effective for the Company January 1, 2018, but it is not expected to have a material impact on the Company's financial statements.

In January 2017, the FASB issued *Accounting Standards Update 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business*. The amendment in this ASU clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) or assets or businesses. The amendments are effective for fiscal years beginning after December 15, 2017, including interim periods within those periods. This ASU is not expected impact the Company's consolidated financial statements.

In January 2017, the FASB issued Accounting Standards Update No. 2017-04, *Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*, to simplify how entities other than private companies, such as public business entities and not-for-profit entities, are required to test goodwill for impairment by eliminating the comparison of the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. The amendments are effective for fiscal years beginning after December 15, 2019, including interim periods within those periods. Adoption of this standard is not expected to have a material impact on the Company's 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*. These amendments shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The guidance is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted with modified retrospective application; however, the Company is not expecting to early adopt. The Company is currently evaluating the impact of the new guidance on its consolidated financial statements.

In August 2017, the FASB issued ASU 2017-12, *Targeted Improvements to Accounting for Hedging Activities*. The objective of this ASU is to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition to that main objective, the amendments in this Update make certain targeted improvements to simplify the application of the hedge accounting guidance in current GAAP. This Update is effective for public business entities for fiscal years beginning after December 15, 2018, and early application is permitted in any interim period after issuance of the Update. The Company currently does not have any hedging activities that would be subject to this Update; however, management may consider hedging activities in the future. Adoption of this Update is not expected to have a material impact on the Company's consolidated financial statements.

## NOTE 2 - SECURITIES

The following table summarizes the amortized cost and fair value of the available for sale securities portfolio at December 31, 2017 and 2016 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive loss.

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<u>December 31, 2017</u>				
U.S. Treasury securities	\$ 229,119	\$ —	\$ (210)	\$228,909
U.S. government sponsored entities and agencies	20,125	—	(164)	19,961
Mortgage-backed securities: residential	641,225	102	(8,761)	632,566
Mortgage-backed securities: commercial	5,133	—	(59)	5,074
State and political subdivisions	113,468	1,787	(1,884)	113,371
Total	<u>\$1,009,070</u>	<u>\$ 1,889</u>	<u>\$ (11,078)</u>	<u>\$999,881</u>
<u>December 31, 2016</u>				
Mortgage-backed securities: residential	\$ 614,344	\$ 949	\$ (8,208)	\$607,085
Mortgage-backed securities: commercial	19,439	27	(132)	19,334
State and political subdivisions	133,280	238	(5,182)	128,336
Total	<u>\$ 767,063</u>	<u>\$ 1,214</u>	<u>\$ (13,522)</u>	<u>\$754,755</u>

The amortized cost and fair value of the held to maturity securities portfolio at December 31, 2017 and 2016 and the corresponding amounts of gross unrecognized gains and losses were as follows:

	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
<u>December 31, 2017</u>				
Mortgage backed securities: residential	\$ 93,366	\$ 207	\$ (1,796)	\$ 91,777
State and political subdivisions	121,490	4,379	(38)	125,831
Total	<u>\$214,856</u>	<u>\$ 4,586</u>	<u>\$ (1,834)</u>	<u>\$217,608</u>
<u>December 31, 2016</u>				
U.S. government sponsored entities and agencies	\$ 203	\$ 6	\$ —	\$ 209
Mortgage backed securities: residential	106,169	328	(2,343)	104,154
State and political subdivisions	122,522	1,214	(207)	123,529
Total	<u>\$228,894</u>	<u>\$ 1,548</u>	<u>\$ (2,550)</u>	<u>\$227,892</u>

The mortgage backed securities in which the Company has invested, both available for sale and held to maturity, are either issued by or guaranteed by Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA), or Government National Mortgage Association (GNMA).

The proceeds from sales, calls, and prepayments of available for sale securities and the associated gains and losses were as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Proceeds from sales	\$240,175	\$93,873	\$107,300
Proceeds from calls and prepayments	—	11,805	2,000
Gross gains	1,553	2,557	972
Gross losses	(657)	(385)	(288)

Calls of held to maturity securities resulted in gross gains of \$149 during 2015. Gross proceeds from these calls totaled \$2,300.

The amortized cost and fair value of the investment securities portfolio are shown by contractual maturity. Securities not due at a single maturity date, primarily mortgage-backed securities, are shown separately.

	<u>December 31, 2017</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>
Available for sale		
Three months or less	\$ —	\$ —
Over three months through one year	229,119	228,909
Over one year through five years	20,125	19,961
Over five years through ten years	420	432
Over ten years	113,048	112,939
Mortgage-backed securities: commercial	5,133	5,074
Mortgage-backed securities: residential	641,225	632,566
Total	<u>\$1,009,070</u>	<u>\$999,881</u>
Held to maturity		
Three months or less	\$ —	\$ —
Over three months through one year	—	—
Over one year through five years	1,607	1,651
Over five years through ten years	6,296	6,452
Over ten years	113,587	117,728
Mortgage-backed securities: residential	93,366	91,777
Total	<u>\$ 214,856</u>	<u>\$217,608</u>

Securities pledged at December 31, 2017 and 2016 had a carrying amount of \$975,518 and \$808,224 and were pledged to secure public deposits and repurchase agreements.

At December 31, 2017 and 2016, there were no holdings of securities of any one issuer, other than the U.S. government-sponsored entities and agencies, in an amount greater than 10% of shareholders' equity.

The following table summarizes the securities with unrealized and unrecognized losses at December 31, 2017 and 2016, aggregated by major security type and length of time in a continuous unrealized loss position:

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<u>December 31, 2017</u>						
Available for sale						
U.S. Treasury securities	\$228,909	\$ (210)	\$ —	\$ —	\$228,909	\$ (210)
U.S. government sponsored entities and agencies	19,961	(164)	—	—	19,961	(164)
Mortgage-backed securities: residential	301,158	(2,447)	311,366	(6,314)	612,524	(8,761)
Mortgage-backed securities: commercial	5,074	(59)	—	—	5,074	(59)
State and political subdivisions	1,298	(2)	62,725	(1,882)	64,023	(1,884)
Total available for sale	<u>\$556,400</u>	<u>\$ (2,882)</u>	<u>\$374,091</u>	<u>\$ (8,196)</u>	<u>\$930,491</u>	<u>\$ (11,078)</u>

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses
Held to maturity						
Mortgage-backed securities: residential	\$ 11,191	\$ (69)	\$ 72,582	\$ (1,727)	\$ 83,773	\$ (1,796)
State and political subdivisions	262	(2)	1,148	(36)	1,410	(38)
Total held to maturity	<u>\$ 11,453</u>	<u>\$ (71)</u>	<u>\$ 73,730</u>	<u>\$ (1,763)</u>	<u>\$ 85,183</u>	<u>\$ (1,834)</u>

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<u>December 31, 2016</u>						
Available for sale						
Mortgage-backed securities: residential	\$465,416	\$ (7,833)	\$ 9,907	\$ (375)	\$475,323	\$ (8,208)
Mortgage-backed securities: commercial	15,752	(132)	—	—	15,752	(132)
State and political subdivisions	100,020	(5,182)	—	—	100,020	(5,182)
Total available for sale	<u>\$581,188</u>	<u>\$ (13,147)</u>	<u>\$ 9,907</u>	<u>\$ (375)</u>	<u>\$591,095</u>	<u>\$ (13,522)</u>

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses
Held to maturity						
Mortgage-backed securities: residential	\$ 89,523	\$ (2,244)	\$ 3,025	\$ (99)	\$ 92,548	\$ (2,343)
State and political subdivisions	18,907	(207)	—	—	18,907	(207)
Total held to maturity	<u>\$108,430</u>	<u>\$ (2,451)</u>	<u>\$ 3,025</u>	<u>\$ (99)</u>	<u>\$111,455</u>	<u>\$ (2,550)</u>

Unrealized losses on debt securities have not been recognized into income because the issuers bonds are of high credit quality (rated AA or higher), management does not intend to sell and it is likely that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates and other market conditions. The fair value is expected to recover as the bonds approach maturity. At December 31, 2017, the Company had 163 available for sale securities in an unrealized loss position and 33 held to maturity securities in an unrecognized loss position compared to 162 available for sale securities in an unrealized loss position and 38 held to maturity securities in an unrecognized loss position at December 31, 2016.



### NOTE 3 - LOANS

Loans at December 31, 2017 and 2016 were as follows:

	December 31, 2017	December 31, 2016
<u>Loans that are not PCI loans</u>		
Construction and land development	\$ 494,818	\$ 489,562
Commercial real estate:		
Nonfarm, nonresidential	628,554	458,569
Other	49,684	38,571
Residential real estate:		
Closed-end 1-4 family	407,695	254,474
Other	169,640	150,515
Commercial and industrial	502,006	376,476
Consumer and other	3,781	3,359
Loans before net deferred loan fees	2,256,178	1,771,526
Deferred loan fees, net	(1,963)	(793)
Total loans that are not PCI loans	2,254,215	1,770,733
Total PCI loans	2,393	2,859
Allowance for loan losses	(21,247)	(16,553)
Total loans, net of allowance for loan losses	<u>\$ 2,235,361</u>	<u>\$ 1,757,039</u>

The following table presents the activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2017, 2016 and 2015:

	Construction and Land Development	Commercial Real Estate	Residential Real Estate	Commercial and Industrial	Consumer and Other	Total
<u>December 31, 2017</u>						
Allowance for loan losses:						
Beginning balance	\$ 3,776	\$ 4,266	\$ 2,398	\$ 6,068	\$ 45	\$16,553
Provision for loan losses	(642)	1,715	1,387	1,823	30	4,313
Loans charged-off	—	—	(1)	(310)	(49)	(360)
Recoveries	668	—	50	6	17	741
Total ending allowance balance	<u>\$ 3,802</u>	<u>\$ 5,981</u>	<u>\$ 3,834</u>	<u>\$ 7,587</u>	<u>\$ 43</u>	<u>\$21,247</u>
<u>December 31, 2016</u>						
Allowance for loan losses:						
Beginning balance	\$ 3,186	\$ 3,146	\$ 1,861	\$ 3,358	\$ 36	\$11,587
Provision for loan losses	601	1,120	511	2,964	44	5,240
Loans charged-off	(11)	—	(40)	(255)	(42)	(348)
Recoveries	—	—	66	1	7	74
Total ending allowance balance	<u>\$ 3,776</u>	<u>\$ 4,266</u>	<u>\$ 2,398</u>	<u>\$ 6,068</u>	<u>\$ 45</u>	<u>\$16,553</u>

	Construction and Land Development	Commercial Real Estate	Residential Real Estate	Commercial and Industrial	Consumer and Other	Total
<u>December 31, 2015</u>						
Allowance for loan losses:						
Beginning balance	\$ 2,690	\$ 1,494	\$ 1,791	\$ 650	\$ 55	\$ 6,680
Provision for loan losses	496	1,652	76	2,755	51	5,030
Loans charged-off	—	—	(32)	(48)	(135)	(215)
Recoveries	—	—	26	1	65	92
Total ending allowance balance	<u>\$ 3,186</u>	<u>\$ 3,146</u>	<u>\$ 1,861</u>	<u>\$ 3,358</u>	<u>\$ 36</u>	<u>\$11,587</u>

For the years ended December 31, 2017 and 2016, there was \$0 in allowance for loan losses for PCI loans.

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2017 and 2016. Purchased and PCI loans are also included in the table. For purposes of this disclosure, recorded investment in loans excludes accrued interest receivable and loan fees, net due to immateriality.

	Construction and Land Development	Commercial Real Estate	Residential Real Estate	Commercial and Industrial	Consumer and Other	Total
<u>December 31, 2017</u>						
Allowance for loan losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	\$ —	\$ —	\$ —	\$ 879	\$ —	\$ 879
Collectively evaluated for impairment	3,802	5,981	3,834	6,708	43	20,368
Purchased credit-impaired loans	—	—	—	—	—	—
Total ending allowance balance	<u>\$ 3,802</u>	<u>\$ 5,981</u>	<u>\$ 3,834</u>	<u>\$ 7,587</u>	<u>\$ 43</u>	<u>\$ 21,247</u>
Loans:						
Individually evaluated for impairment	\$ 217	\$ —	\$ 834	\$ 3,090	\$ —	\$ 4,141
Collectively evaluated for impairment	494,601	678,238	576,501	498,916	3,781	2,252,037
Purchased credit-impaired loans	—	380	105	1,908	—	2,393
Total ending loans balance	<u>\$ 494,818</u>	<u>\$ 678,618</u>	<u>\$577,440</u>	<u>\$ 503,914</u>	<u>\$ 3,781</u>	<u>\$2,258,571</u>
<u>December 31, 2016</u>						
Allowance for loan losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	\$ —	\$ —	\$ —	\$ 1,024	\$ —	\$ 1,024
Collectively evaluated for impairment	3,776	4,266	2,398	5,044	45	15,529
Purchased credit-impaired loans	—	—	—	—	—	—
Total ending allowance balance	<u>\$ 3,776</u>	<u>\$ 4,266</u>	<u>\$ 2,398</u>	<u>\$ 6,068</u>	<u>\$ 45</u>	<u>\$ 16,553</u>
Loans:						
Individually evaluated for impairment	\$ 1,275	\$ 2,836	\$ 2,190	\$ 3,608	\$ —	\$ 9,909
Collectively evaluated for impairment	488,287	494,304	402,799	372,868	3,359	1,761,617
Purchased credit-impaired loans	—	394	496	1,969	—	2,859
Total ending loans balance	<u>\$ 489,562</u>	<u>\$ 497,534</u>	<u>\$405,485</u>	<u>\$ 378,445</u>	<u>\$ 3,359</u>	<u>\$1,774,385</u>

Loans collectively evaluated for impairment reported at December 31, 2017 include certain loans acquired from MidSouth on July 1, 2014. The acquired loans were recorded at estimated fair value at date of acquisition, which included an estimated credit discount. On July 1, 2014, acquired non-PCI loans were recorded at an estimated fair value of \$178,818, comprised of contractually unpaid principal totaling \$183,832 net of estimated discounts totaling \$5,014 which included both credit and interest rate discount components. As of December 31, 2017, these non-PCI loans had a carrying value of \$50,341, comprised of contractually unpaid principal totaling \$51,767 and discounts totaling \$1,426. Management evaluated these loans for credit deterioration since acquisition and determined that a \$10 allowance for loan losses was necessary at December 31, 2017.

The following table presents information related to impaired loans by class of loans as of December 31, 2017 and 2016:

	<u>Unpaid Principal Balance</u>	<u>Recorded Investment</u>	<u>Allowance for Loan Losses Allocated</u>
<u>December 31, 2017</u>			
With no allowance recorded:			
Construction and land development	\$ 217	\$ 217	\$ —
Residential real estate:			
Closed-end 1-4 family	14	14	—
Other	820	820	—
Commercial and industrial	108	108	—
Subtotal	<u>1,159</u>	<u>1,159</u>	<u>—</u>
With an allowance recorded:			
Commercial and industrial	<u>2,982</u>	<u>2,982</u>	<u>879</u>
Subtotal	<u>2,982</u>	<u>2,982</u>	<u>879</u>
Total	<u>\$ 4,141</u>	<u>\$ 4,141</u>	<u>\$ 879</u>
<u>December 31, 2016</u>			
With no allowance recorded:			
Construction and land development	\$ 1,275	\$ 1,275	\$ —
Commercial real estate:			
Nonfarm, nonresidential	4,423	2,836	—
Residential real estate:			
Closed-end 1-4 family	2,069	2,069	—
Other	121	121	—
Commercial and industrial	934	934	—
Subtotal	<u>8,822</u>	<u>7,235</u>	<u>—</u>
With an allowance recorded:			
Commercial and industrial	<u>2,864</u>	<u>2,674</u>	<u>1,024</u>
Subtotal	<u>2,864</u>	<u>2,674</u>	<u>1,024</u>
Total	<u>\$11,686</u>	<u>\$ 9,909</u>	<u>\$ 1,024</u>

The following table presents the average recorded investment of impaired loans by class of loans for the years ended December 31, 2017, 2016 and 2015:

<u>Average Recorded Investment</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
With no allowance recorded:			
Construction and land development	\$ 921	\$ 474	\$ 494
Commercial real estate:			
Nonfarm, nonresidential	1,796	1,892	882
Residential real estate:			
Closed-end 1-4 family	649	747	261
Other	331	696	415
Commercial and industrial	899	207	62
Consumer and other	1	8	10
Subtotal	<u>4,597</u>	<u>4,024</u>	<u>2,124</u>
With an allowance recorded:			
Residential real estate:			
Closed-end 1-4 family	22	55	—
Commercial and industrial	2,480	490	60
Consumer and other	—	—	8
Subtotal	<u>2,502</u>	<u>545</u>	<u>68</u>
Total	<u>\$7,099</u>	<u>\$4,569</u>	<u>\$2,192</u>

The impact on net interest income for these loans was not material to the Company's results of operations for the years ended December 31, 2017, 2016 and 2015.

The following table presents the recorded investment in nonaccrual and loans past due over 90 days still on accrual by class of loans as of December 31, 2017 and 2016:

	<u>Nonaccrual</u>	<u>Loans Past Due Over 90 Days</u>
<u>December 31, 2017</u>		
Residential real estate:		
Closed-end 1-4 family	\$ 257	\$ 14
Other	114	—
Commercial and industrial	2,466	191
Total	<u>\$ 2,837</u>	<u>\$ 205</u>
<u>December 31, 2016</u>		
Construction and land development	\$ —	\$ 1,950
Commercial real estate:		
Nonfarm, nonresidential	835	—
Residential real estate:		
Closed-end 1-4 family	—	452
Other	121	—
Commercial and industrial	2,674	150
Total	<u>\$ 3,630</u>	<u>\$ 2,552</u>

Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following table presents the aging of the recorded investment in past due loans as of December 31, 2017 and 2016 by class of loans:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 89 Days Past Due	Total Past Due	Loans Not Past Due	PCI Loans	Total
<u>December 31, 2017</u>							
Construction and land development	\$ 1,918	\$ 136	\$ —	\$ 2,054	\$ 492,764	\$ —	\$ 494,818
Commercial real estate:							
Nonfarm, nonresidential	—	—	—	—	628,554	380	628,934
Other	—	—	—	—	49,684	—	49,684
Residential real estate:							
Closed-end 1-4 family	257	—	14	271	407,424	105	407,800
Other	146	719	114	979	168,661	—	169,640
Commercial and industrial	532	27	2,657	3,216	498,790	1,908	503,914
Consumer and other	—	—	—	—	3,781	—	3,781
	<u>\$ 2,853</u>	<u>\$ 882</u>	<u>\$ 2,785</u>	<u>\$ 6,520</u>	<u>\$2,249,658</u>	<u>\$2,393</u>	<u>\$2,258,571</u>
<u>December 31, 2016</u>							
Construction and land development	\$ 380	\$ —	\$ 1,950	\$ 2,330	\$ 487,232	\$ —	\$ 489,562
Commercial real estate:							
Nonfarm, nonresidential	664	—	835	1,499	457,070	394	458,963
Other	—	—	—	—	38,571	—	38,571
Residential real estate:							
Closed-end 1-4 family	428	10	452	890	253,584	496	254,970
Other	231	—	121	352	150,163	—	150,515
Commercial and industrial	155	39	2,824	3,018	373,458	1,969	378,445
Consumer and other	—	—	—	—	3,359	—	3,359
	<u>\$ 1,858</u>	<u>\$ 49</u>	<u>\$ 6,182</u>	<u>\$ 8,089</u>	<u>\$1,763,437</u>	<u>\$2,859</u>	<u>\$1,774,385</u>

**Credit Quality Indicators:** The Company categorizes loans into risk categories 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. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes non-homogeneous loans, such as commercial and commercial real estate loans as well as non-homogeneous residential real estate loans. This analysis is performed on a quarterly basis. The Company uses the following definitions for risk ratings:

**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.

**Substandard.** Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. The following table includes PCI loans, which are included in the “Substandard” column. Based on the most recent analysis performed, the risk category of loans by class of loans is as follows as of December 31, 2017 and 2016:

	Pass	Special Mention	Substandard	Total
<u>December 31, 2017</u>				
Construction and land development	\$ 494,601	\$ —	\$ 217	\$ 494,818
Commercial real estate:				
Nonfarm, nonresidential	609,458	12,602	6,874	628,934
Other	49,303	—	381	49,684
Residential real estate:				
Closed-end 1-4 family	404,832	615	2,353	407,800
Other	167,886	—	1,754	169,640
Commercial and industrial	485,363	10,350	8,201	503,914
Consumer and other	3,777	4	—	3,781
	<u>\$2,215,220</u>	<u>\$23,571</u>	<u>\$ 19,780</u>	<u>\$2,258,571</u>
<u>December 31, 2016</u>				
Construction and land development	\$ 488,287	\$ —	\$ 1,275	\$ 489,562
Commercial real estate:				
Nonfarm, nonresidential	449,373	1,847	7,743	458,963
Other	38,571	—	—	38,571
Residential real estate:				
Closed-end 1-4 family	251,919	—	3,051	254,970
Other	149,504	—	1,011	150,515
Commercial and industrial	373,243	—	5,202	378,445
Consumer and other	3,359	—	—	3,359
	<u>\$1,754,256</u>	<u>\$ 1,847</u>	<u>\$ 18,282</u>	<u>\$1,774,385</u>

### Troubled Debt Restructurings

As of December 31, 2017, the Company’s loan portfolio contains one loan in the amount of \$608 that has been modified in a troubled debt restructuring as of December 31, 2017. There was one loan in the amount of \$698 that has been modified in troubled debt restructurings as of December 31, 2016.

### NOTE 4 - LOAN SERVICING

Loans serviced for others are not reported as assets. The principal balances of these loans at December 31, 2017 and 2016 are as follows:

	2017	2016
Loan portfolios serviced for:		
Federal Home Loan Mortgage Corporation	\$507,233	\$499,385
Other	4,626	2,954

Custodial escrow balances maintained in connection with serviced loans were \$2,672 and \$2,477 at year-end 2017 and 2016.

The related loan servicing rights activity for the years ended December 31, 2017, 2016 and 2015 were as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Servicing rights:			
Beginning of year	\$3,621	\$ 3,455	\$3,053
Additions	933	1,367	1,311
Amortized to expense	(934)	(1,201)	(909)
Decrease in impairment	—	—	—
End of year	<u>\$3,620</u>	<u>\$ 3,621</u>	<u>\$3,455</u>

The components of net loan servicing fees for the years ended December 31, 2017, 2016 and 2015 were as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Loan servicing fees, net:			
Loan servicing fees	\$1,270	\$ 1,223	\$1,136
Amortization of loan servicing fees	(934)	(1,201)	(909)
Change in impairment	—	—	—
Total	<u>\$ 336</u>	<u>\$ 22</u>	<u>\$ 227</u>

The fair value of servicing rights was estimated by management to be approximately \$5,089 at December 31, 2017. Fair value for 2017 was determined using a weighted average discount rate of 10.5% and a weighted average prepayment speed of 9.9%. At December 31, 2016, the fair value of servicing rights was estimated by management to be approximately \$5,015. Fair value for 2016 was determined using weighted average discount rate of 10.5% and a weighted average prepayment speed of 9.9%.

#### **NOTE 5 - PREMISES AND EQUIPMENT AND LEASES**

Year-end premises and equipment were as follows:

	<u>2017</u>	<u>2016</u>
Construction in progress	\$ 3,215	\$ 2,184
Land and land improvements	33	33
Buildings	150	150
Leasehold improvements	7,582	6,149
Furniture, fixtures, and equipment	5,437	5,229
Computer equipment and software	3,380	2,840
Automobiles	29	29
	<u>19,826</u>	<u>16,614</u>
Accumulated depreciation	<u>(8,545)</u>	<u>(7,063)</u>
	<u>\$11,281</u>	<u>\$ 9,551</u>

Depreciation and amortization expense was \$1,482, \$1,330 and \$1,325 for the years ended December 31, 2017, 2016 and 2015, respectively.

Operating Leases: The Company leases most of its branches, loan production, and administrative offices under operating leases. Rent expense was \$4,454, \$3,602 and \$2,912 for 2017, 2016 and 2015, respectively. Rent commitments, over the initial lease terms and intended renewal periods were as follows:

	<u>Related Parties</u>	<u>Other</u>	<u>Total</u>
2018	\$ 3,231	\$ 1,292	\$ 4,523
2019	3,277	1,273	4,550
2020	3,324	1,210	4,534
2021	3,371	1,230	4,601
2022	3,420	1,207	4,627
Thereafter	<u>30,845</u>	<u>7,305</u>	<u>38,150</u>
Total	<u>\$47,468</u>	<u>\$13,517</u>	<u>\$60,985</u>

#### **NOTE 6 – GOODWILL AND INTANGIBLE ASSETS**

Goodwill: Goodwill was \$9,124 at both December 31, 2017 and 2016.

Impairment exists when a reporting unit's carrying value of goodwill exceeds its fair value. At December 31, 2017, the Company's reporting unit had positive equity and the Company elected to perform a qualitative assessment to determine if it was more likely than not that the fair value of the reporting unit exceeded its carrying value, including goodwill. The qualitative assessment indicated that it was more likely than not that the fair value of the reporting unit exceeded its carrying value, resulting in no impairment.

Acquired Intangible Assets: As of December 31, 2017 and 2016, the Company had net core deposit intangibles of \$1,007 and \$1,480, respectively, all of which is attributed to the acquisition of MidSouth. At the time of the acquisition, the Company recorded a core deposit intangible of \$3,060, which is being amortized over 8.2 years. Through December 31, 2017, the Company has recognized amortization of \$2,053 related to the core deposit intangible.

The following table represents acquired intangible assets at December 31, 2017 and 2016:

	<u>2017</u>		<u>2016</u>	
	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>
Acquired intangible assets:				
Core deposit intangibles	\$ 3,060	\$ (2,053)	\$ 3,060	\$ (1,580)

Aggregate amortization expense was \$473, \$563 and \$655 for 2017, 2016 and 2015, respectively.

The following table presents estimated amortization expense for each of the next five years:

2018	382
2019	291
2020	201
2021	110
2022	23



## NOTE 7 - DEPOSITS

At December 31, 2017 and 2016, time deposits in denominations of \$250 or greater totaled \$392,633 and \$289,571, respectively. At December 31, 2017 and 2016, the Company had \$224 and \$192, respectively, of deposit accounts in overdraft status and thus have been reclassified to loans on the accompanying consolidated balance sheets.

Scheduled maturities of time deposits for the next five years were as follows:

2018	\$875,033
2019	193,967
2020	65,102
2021	56,984
2022	39,350

## NOTE 8 - FEDERAL FUNDS PURCHASED AND REPURCHASE AGREEMENTS

As of December 31, 2017 and 2016, the Bank had federal funds lines (or the equivalent thereof) with correspondent banks totaling \$217,500 and \$199,900, respectively. There was \$0 and \$46,805 in outstanding federal funds purchased at December 31, 2017 and 2016, respectively.

The Bank enters into borrowing arrangements with our retail business customers and correspondent banks through agreements to repurchase (“securities sold under agreements to repurchase”) under which the bank pledges investment securities owned and under its control as collateral against these short-term borrowing arrangements. At maturity the securities underlying the agreements are returned to the Company. At December 31, 2017 and December 31, 2016, these short-term borrowings totaled \$31,004 and \$36,496, respectively, and are secured by securities with carrying amounts of \$41,618 and \$41,136, respectively. At December 31, 2017, the Company had \$31,004 in repurchase agreements that had one-day maturities.

Information concerning securities sold under agreements to repurchase is summarized as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Average daily balance during the year	\$32,428	\$39,647	\$38,241
Average interest rate during the year	0.85%	0.58%	0.53%
Maximum month-end balance during the year	\$33,989	\$61,669	\$61,261
Weighted average interest rate at year end	1.14%	0.56%	0.64%

The following table provides additional details as of December 31, 2017:

<u>As of December 31, 2017</u>	<u>U.S. Government Sponsored Entities and Agencies Securities</u>	<u>Mortgage- Backed Securities: Residential</u>	<u>State and Political Subdivisions</u>	<u>Total</u>
Market value of securities pledged	\$ —	\$ 1,004	\$ 42,109	\$43,113
Borrowings related to pledged amounts	\$ —	\$ —	\$ 31,004	\$31,004
Market value pledged as a % of borrowings	— %	— %	136%	139%

## NOTE 9 – FEDERAL HOME LOAN BANK ADVANCES

The Bank has established a line of credit with the Federal Home Loan Bank of Cincinnati (“FHLB”), which is secured by a blanket pledge of 1-4 family residential mortgage loans and home equity lines of credit. The availability of the line is dependent, in part, on available collateral.

At December 31, 2017 and 2016, the Company had received advances from the FHLB totaling \$272,000 and \$132,000, respectively. At December 31, 2017, the scheduled maturities of these advances and interest rates were as follows:

	<u>Scheduled Maturities</u>	<u>Weighted Average Rates</u>
2018	\$157,000	1.19%
2019	60,000	1.46%
2020	55,000	1.72%
2021	—	—
2022	—	—
Thereafter	—	—
Total	<u>\$272,000</u>	<u>1.36%</u>

Each FHLB advance is payable at its maturity date, with a prepayment penalty for fixed rate advances. Qualifying loans totaling approximately \$573,827 were pledged as security under a blanket pledge agreement with the FHLB at December 31, 2017. Based on this collateral and the Company’s holdings of FHLB stock, the Bank is eligible to borrow up to an additional \$70,004 as of December 31, 2017.

## NOTE 10 – SUBORDINATED NOTES

At December 31, 2017, the Company’s subordinated notes, net of issuance costs, totaled \$58,515. The Company’s subordinated notes, net of issuance costs, totaled \$58,337 at December 31, 2016. For regulatory capital purposes, the subordinated notes are treated as Tier 2 capital, subject to certain limitations, and are included in total regulatory capital when calculating the Company’s total capital to risk weighted assets ratio as indicated in Note 15 of the consolidated financial statements.

The Company completed the issuance of \$60,000 in principal amount of subordinated notes in two separate offerings. In March 2016, \$40,000 of 6.875% fixed-to-floating rate subordinated notes were issued in a public offering to accredited institutional investors, and in June 2016, \$20,000 of 7.00% fixed-to-floating rate subordinated notes were issued to certain accredited institutional investors in a private offering. The subordinated notes are unsecured and will rank at least equally with all of the Company’s other unsecured subordinated indebtedness and will be effectively subordinated to all of our secured debt to the extent of the value of the collateral securing such debt. The subordinated notes will be subordinated in right of payment to all of our existing and future senior indebtedness, and will rank structurally junior to all existing and future liabilities of our subsidiaries including, in the case of the Company’s bank subsidiary, its depositors, and any preferred equity holders of our subsidiaries. The holders of the subordinated notes may be fully subordinated to interests held by the U.S. government in the event that we enter into a receivership, insolvency, liquidation, or similar proceeding.

The following table summarizes the terms of each subordinated note offering:

	<u>March 2016 Subordinated Notes</u>	<u>June 2016 Subordinated Notes</u>
Principal amount issued	\$40,000	\$20,000
Maturity date	March 30, 2026	July 1, 2026
Initial fixed interest rate	6.875%	7.00%
Initial interest rate period	5 years	5 years
First interest rate change date	March 30, 2021	July 1, 2021
Interest payment frequency through year five*	Semiannually	Semiannually
Interest payment frequency after five years*	Quarterly	Quarterly
Interest repricing index and margin	3-month LIBOR plus 5.636%	3-month LIBOR plus 6.04%
Repricing frequency after five years	Quarterly	Quarterly

\* The Company currently may not make interest payments on either series of subordinated notes without prior written approval from its primary regulatory agencies.

The Company used the net proceeds from the March 2016 Subordinated Notes offering to pay off a \$10 million borrowing that had been used to redeem the shares of Senior Non-Cumulative Perpetual Preferred Stock, Series A (the “Series A Preferred Stock”) issued to the United States Department of the Treasury (“Treasury”) in connection with the Company’s participation in the Small Business Lending Fund and to fund future growth of the Bank. The Company used the net proceeds from the June 2016 Subordinated Notes to fund future growth of the Bank.

The issuance costs related to the March 2016 Subordinated Notes amounted to \$1,382 and are being amortized as interest expense over the ten-year term of the March 2016 Subordinated Notes. The issuance costs related to the June 2016 Subordinated Notes were \$404 and are being amortized as interest expense over the ten-year term of the June 2016 Notes.

#### NOTE 11 – BENEFIT PLANS

A 401(k) benefit plan was adopted to begin benefits on May 1, 2008. The 401(k) benefit plan allows employee contributions of their compensation subject to certain limitations. Employee contributions are matched in the Company’s common stock equal to 100% of the first 2% of the compensation contributed and 50% of the next 4% of the compensation contributed. Expense for the years ended December 31, 2017, 2016 and 2015 was \$621, \$523 and \$466, respectively.

#### NOTE 12 – INCOME TAXES

A reconciliation of the income tax expense for the years ended December 31, 2017, 2016 and 2015 to the “expected” tax expense, which was computed by applying the statutory federal income tax rate of 35 percent for 2017, 2016 and 2015 to income before income tax expense, is as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Computed “expected” tax expense	\$16,321	\$13,931	\$8,785
Increase (reduction) in tax expense resulting from:			
State tax expense, net of federal tax effect	333	805	1,031
Effect of statutory rate changes enacted <sup>(1)</sup>	5,323	—	—
Non-deductible merger costs	19	114	20
Incentive stock options	429	152	58
Bank owned life insurance	(286)	(227)	(214)
Tax-exempt interest income, net of expense	(2,585)	(1,801)	(703)
Insurance premiums	(347)	(364)	—
Excess tax benefit from exercise of stock options and vesting of restricted stock	(728)	(911)	—
Other	52	47	44
Income tax expense	<u>\$18,531</u>	<u>\$11,746</u>	<u>\$9,021</u>

<sup>(1)</sup> 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. As a result of the changes under the Tax Act, the Company recorded incremental income tax expense of \$5,323 during the year ended December 31, 2017, which consisted primarily of the remeasurement of deferred tax assets and liabilities at the new federal statutory rate of 21%. Prior to the enactment of the Tax Act, deferred tax assets and liabilities were measured at the previous federal statutory rate of 35%.

Income tax expense (benefit) was as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Current expense			
Federal	\$13,653	\$11,416	\$8,302
State	1,093	1,294	1,777
Deferred expense			
Federal	(957)	(908)	(867)
State	(581)	(56)	(191)
Deferred tax revaluation expense	5,323	—	—
Income tax expense	<u>\$18,531</u>	<u>\$11,746</u>	<u>\$9,021</u>

The sources of deferred income tax assets (liabilities) at December 31, 2017 and 2016 and the tax effect is as follows:

	<u>2017</u>	<u>2016</u>
Deferred tax assets:		
Organizational and start-up costs	\$ 64	\$ 115
Allowance for loan losses	5,367	6,340
Unrealized loss on securities	2,403	4,826
Net operating loss carry forward	2,317	4,332
Purchase accounting fair value adjustments	1,006	1,914
Accrued other expenses	567	512
Nonaccrual loan interest	355	468
Loan fees	511	312
Other	552	139
Total deferred tax asset	<u>13,142</u>	<u>18,958</u>
Deferred tax liabilities:		
Mortgage servicing rights	\$ (933)	\$ (1,429)
Premises and equipment	(753)	(1,080)
Prepaid expenses	(469)	(527)
Purchase accounting fair value adjustments	(264)	(639)
Mortgage banking derivatives	—	(8)
Other	(716)	(262)
Total deferred tax liability	<u>(3,135)</u>	<u>(3,945)</u>
Net deferred tax asset	<u>\$10,007</u>	<u>\$15,013</u>

At December 31, 2017, the federal net operating loss remaining from the acquisition of MidSouth Bank totaled \$11.0 million, which will expire at various dates from 2025 to 2031. The federal net operating losses that can be utilized are subject to an annual limitation of \$1.3 million. Deferred tax assets are recognized for net operating losses because the benefit is more likely than not to be realized.

The Company does not have any uncertain tax positions and did not have any interest and penalties recorded in the income statement for the years ended December 31, 2017, 2016 and 2015. The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax of the state of Tennessee. The Company is no longer subject to examination by taxing authorities for years before 2014.

### NOTE 13 – RELATED PARTY TRANSACTIONS

The Company enters into various credit arrangements with its executive officers, directors and their affiliates. These arrangements generally take the form of commercial lines of credit, personal lines of credit, mortgage loans, term loans or revolving arrangements secured by personal residences.

Loans to principal officers, directors, and their affiliates during 2017 were as follows:

Beginning balance	\$13,571
New loans/advances	20,129
Effect of changes in composition of related parties	—
Participations sold	(1,100)
Repayments	(3,413)
Ending balance	<u>\$29,187</u>

Deposits from principal officers, directors, and their affiliates at year end 2017 and 2016 were \$17,477 and \$18,836.

The Company entered into a 15-year lease agreement for a branch and administrative facility in downtown Franklin, Tennessee on May 7, 2010. The Company also entered into a 15-year lease for its Berry Farms branch in Franklin, Tennessee, on June 12, 2013 with certain outside directors of the Company. The Berry Farms branch opened during 2013. During 2014, the Company entered into 15-year lease agreements for an addition to its branch and administrative facility in downtown Franklin and for its Cool Springs branch in Franklin, Tennessee. During 2015, the Company entered into 15-year lease agreements for three of its Rutherford County branches that were acquired during the acquisition of MidSouth Bank during 2014. During 2015, these three buildings sold to related parties, and lease agreements were executed upon completion of the sale, and during 2016, these properties were sold by the Company's related parties to an outside party. During 2015, the Company also entered into a lease agreement to expand its downtown Franklin location by adding a mortgage facility and parking garage. The expansion to the downtown Franklin location was completed during 2016.

Rent expense attributable to related party leases in 2017, 2016 and 2015, was \$2,582, \$2,574 and \$2,296, respectively. Rent commitments to related parties, before considering renewal options that generally are present, are disclosed in Note 5. The Company also paid a company affiliated with an outside director \$831, \$2,261 and \$369 for construction of leasehold improvements during 2017, 2016 and 2015, respectively. In addition, the Company also paid a company affiliated with an outside director \$997, \$806 and \$666 for the procurement of various insurance policies during the years ending December 31, 2017, 2016 and 2015, respectively.

### NOTE 14 - SHARE-BASED PAYMENTS

In connection with the Company's 2010 private offering, 32,425 warrants were issued to shareholders, one warrant for every twenty shares of common stock purchased. Each warrant allowed the shareholders to purchase an additional share of common stock at \$12.00 per share. The warrants were issued with an effective date of March 30, 2010 and were exercisable in whole or in part up to seven years following the date of issuance. The warrants were detachable from the common stock. There were 12,461 and 8,450 warrants exercised during 2017 and 2016, respectively. A summary of the stock warrant activity for the years ended December 31, 2017 and 2016 follows:

	<u>2017</u>	<u>2016</u>
Stock warrants exercised:		
Intrinsic value of warrants exercised	\$329	\$181
Cash received from warrants exercised	150	101

The warrants expired on March 30, 2017; therefore, at December 31, 2017, there were no outstanding warrants.

The Company has two share based compensation plans as described below. Total compensation cost that has been charged against income for those plans was \$2,802, \$1,641, and \$860, respectively, for 2017, 2016, and 2015. The total income tax benefit related to vesting of restricted stock and exercises of stock options was \$805, \$1,013, and \$533, respectively, for 2017, 2016 and 2015.

**Stock Option Plan:** The Company's 2007 Omnibus Equity Incentive Plan (the "2007 Plan"), as amended and shareholder-approved, provided for authorized shares up to 4,000,000. The 2007 Plan provided that no options intended to be ISOs may be granted after April 9, 2017. As a result, the Company's board of directors approved, and recommended to its shareholders for approval, an equity

incentive plan, the 2017 Omnibus Equity Incentive Plan. The Company's shareholders approved the 2017 Omnibus Equity Incentive Plan at the 2017 annual meeting of shareholders. The terms of the 2017 Omnibus Equity Incentive Plan are substantially similar to the terms of the 2007 Omnibus Equity Incentive Plan it was intended to replace. The 2017 Omnibus Equity Incentive Plan provides for authorized shares up to 5,000,000. At December 31, 2017, there were 4,734,446 authorized shares available for issuance under the 2017 Omnibus Equity Incentive Plan.

Employee, organizer and director awards are generally granted with an exercise price equal to the market price of the Company's common stock at the date of grant; those option awards have a vesting period of two to five years and have a ten-year contractual term. The Company assigns discretion to its Board of Directors to make grants either as qualified incentive stock options or as non-qualified stock options. All employee grants are intended to be treated as qualified incentive stock options, if allowable. All other grants are expected to be treated as non-qualified.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. Expected stock price volatility is based on historical volatilities of the Company's common stock. The Company uses historical data to estimate option exercise and post-vesting termination behavior.

The expected term of options granted represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant.

The fair value of options granted was determined using the following weighted-average assumptions as of grant date.

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Risk-free interest rate	2.05%	1.59%	1.84%
Expected term	6.9 years	7.5 years	7.5 years
Expected stock price volatility	33.21%	30.45%	25.00%
Dividend yield	0.03%	0.22%	0.22%

The weighted average fair value of options granted for the years ending December 31, 2017, 2016 and 2015 was \$14.43, \$10.23, and \$6.44, respectively.

A summary of the activity in the stock option plans for the years ended December 31, 2017, 2016 and 2015 follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2014	1,210,660	\$ 11.32		
Granted	245,449	20.82		
Exercised	(138,901)	11.53		
Forfeited, expired, or cancelled	(4,417)	19.02		
Outstanding at December 31, 2015	1,312,791	\$ 13.04		
Granted	299,587	28.85		
Exercised	(214,947)	11.31		
Forfeited, expired, or cancelled	(2,415)	19.43		
Outstanding at December 31, 2016	1,395,016	\$ 16.70		
Granted	295,820	37.68		
Exercised	(180,555)	11.87		
Forfeited, expired, or cancelled	(3,113)	25.37		
Outstanding at December 31, 2017	1,507,168	\$ 21.37	6.55	\$ 19,180
Vested or expected to vest	1,431,810	\$ 21.37	6.55	\$ 18,221
Exercisable at December 31, 2017	771,418	\$ 13.79	4.88	\$ 15,666

	2017	2016	2015
Stock options exercised:			
Intrinsic value of options exercised	\$4,878	\$4,725	\$1,727
Cash received from options exercised	1,615	1,571	1,301
Tax benefit realized from option exercises	484	843	451

As of December 31, 2017, there was \$5,854 of total unrecognized compensation cost related to non-vested stock options granted under the Plan. The cost is expected to be recognized over a weighted-average period of 1.8 years.

Restricted Share Award Plan: Additionally, the Company's 2007 Omnibus Equity Incentive Plan and the 2017 Omnibus Equity Incentive Plan provide for the granting of restricted share awards and other performance related incentives. When restricted shares are awarded, a participant receives voting and dividend rights with respect to the shares, but is not able to transfer the shares until the restrictions have lapsed. These awards have a vesting period of two to five years and vest in equal annual installments on the anniversary date of the grant. During 2017, 27,282 restricted share awards were granted from the Company's 2007 Omnibus Equity Incentive Plan. All future restricted share awards will be granted from the 2017 Omnibus Equity Incentive Plan.

A summary of activity for non-vested restricted share awards for the year ended December 31, 2017, 2016 and 2015 is as follows:

<u>Non-vested Shares</u>	<u>Shares</u>	<u>Weighted-Average Grant-Date Fair Value</u>
Non-vested at December 31, 2014	102,710	\$ 13.93
Granted	31,938	20.69
Vested	(25,075)	13.99
Forfeited	(3,709)	15.99
Non-vested at December 31, 2015	105,864	\$ 15.89
Granted	36,496	28.47
Vested	(33,407)	17.06
Forfeited	(2,495)	16.97
Non-vested at December 31, 2016	106,458	19.81
Granted	27,282	37.35
Vested	(38,995)	18.40
Forfeited	(564)	28.66
Non-vested at December 31, 2017	<u>94,181</u>	<u>25.42</u>

Compensation expense associated with the restricted share awards is recognized on a straight-line basis over the time period that the restrictions associated with the awards lapse based on the total cost of the award at the grant date. As of December 31, 2017, there was \$1,822 of total unrecognized compensation cost related to non-vested shares granted under the Plan. The cost is expected to be recognized over a weighted-average period of 3.4 years. The total fair value of shares vested during the years ended December 31, 2017, 2016 and 2015 was \$1,432, \$1,003, and \$560, respectively.

#### **NOTE 15 – REGULATORY CAPITAL MATTERS**

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally 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. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel Committee on Banking Supervision’s capital guidelines 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. Management believes that, as of December 31, 2017, the Company and Bank meet all capital adequacy requirements to which they are subject.

The final rules implementing Basel Committee on Banking Supervision’s capital guidelines 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. Under the Basel III rules, in order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers, a banking organization must hold a capital conservation buffer composed of Common Equity Tier 1 Capital above its minimum risk-based capital requirements. The buffer is measured relative to RWA. Phase-in of the capital conservation buffer requirements began on January 1, 2016 and the requirements will be fully phased in on January 1, 2019. The capital conservation buffer threshold for 2017 is 1.25%. A banking organization with a buffer greater than 2.5% once the capital conservation buffer is fully phased in would not be subject to limits on capital distributions or discretionary bonus payments; however, a banking organization with a buffer of less than 2.5% would be subject to increasingly stringent limitations as the buffer approaches zero. The rule also prohibits a banking organization from making distributions or discretionary bonus payments during any quarter if its eligible retained income is negative in that quarter and its capital conservation buffer ratio was less than 2.5% at the beginning of the quarter. Effectively, the Basel III framework will require us to meet minimum capital ratios of (i) 7% for Common Equity Tier 1 Capital, (ii) 8.5% Tier 1 Capital, and (iii) 10.5% Total Capital. The eligible retained income of a banking organization is defined as its net income for the four calendar quarters preceding the current calendar quarter, based on the organization’s quarterly regulatory reports, net of any distributions and associated tax effects not already reflected in net income. When the new rule is fully phased in, the minimum capital requirements plus the capital conservation buffer will exceed the prompt corrective action (“PCA”) well-capitalized thresholds.

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. At December 31, 2017, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category. Actual and required capital amounts and ratios are presented below as of December 31, 2017 and 2016 for the Company and Bank.

	<u>Actual</u>		<u>Required For Capital Adequacy Purposes</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Regulations</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>December 31, 2017</u>						
Company common equity Tier 1 capital to risk-weighted assets	\$299,229	11.37%	\$ 118,479	4.50%	N/A	N/A
Company Total Capital to risk weighted assets	\$379,083	14.40%	\$ 210,629	8.00%	N/A	N/A
Company Tier 1 (Core) Capital to risk weighted assets	\$299,229	11.37%	\$ 157,972	6.00%	N/A	N/A
Company Tier 1 (Core) Capital to average assets	\$299,229	8.25%	\$ 145,100	4.00%	N/A	N/A
Bank common equity Tier 1 capital to risk-weighted assets	\$353,512	13.43%	\$ 118,489	4.50%	\$171,151	6.50%
Bank Total Capital to risk weighted assets	\$374,851	14.24%	\$ 210,647	8.00%	\$263,309	10.00%
Bank Tier 1 (Core) Capital to risk weighted assets	\$353,512	13.43%	\$ 157,985	6.00%	\$210,647	8.00%
Bank Tier 1 (Core) Capital to average assets	\$353,512	9.75%	\$ 145,003	4.00%	\$181,253	5.00%
<u>December 31, 2016</u>						
Company common equity Tier 1 capital to risk-weighted assets	\$263,693	11.75%	\$ 101,022	4.50%	N/A	N/A
Company Total Capital to risk weighted assets	\$338,675	15.09%	\$ 179,595	8.00%	N/A	N/A
Company Tier 1 (Core) Capital to risk weighted assets	\$263,693	11.75%	\$ 134,696	6.00%	N/A	N/A
Company Tier 1 (Core) Capital to average assets	\$263,693	9.28%	\$ 113,697	4.00%	N/A	N/A
Bank common equity Tier 1 capital to risk-weighted assets	\$319,005	14.18%	\$ 101,216	4.50%	\$146,201	6.50%
Bank Total Capital to risk weighted assets	\$335,650	14.92%	\$ 179,939	8.00%	\$224,924	10.00%
Bank Tier 1 (Core) Capital to risk weighted assets	\$319,005	14.18%	\$ 134,954	6.00%	\$179,939	8.00%
Bank Tier 1 (Core) Capital to average assets	\$319,005	11.22%	\$ 113,697	4.00%	\$142,122	5.00%

Note: Minimum ratios presented exclude the capital conservation buffer.

**Dividend Restrictions:** The Company's principal source of funds for dividend payments is dividends received from the Bank. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. Under these regulations, the amount of dividends that may be paid in any calendar year is limited to the current year's net profits, combined with the retained net profits of the preceding two years, subject to the capital requirements described above. Neither the Company nor the Bank may currently pay dividends without prior written approval from its primary regulatory agencies.

#### **NOTE 16 - FAIR VALUE**

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

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

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

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate the fair value of each type of asset and liability:

Securities: The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2), using matrix pricing. Matrix pricing is a mathematical technique commonly used to price debt securities that are not actively traded, values debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

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

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly. Appraisals for impaired loans are generally obtained annually but may be obtained more frequently based on changing circumstances as part of the aforementioned quarterly evaluation.

Foreclosed Assets: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals which are updated no less frequently than annually. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Foreclosed assets are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Appraisals for both collateral-dependent impaired loans and real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been review and verified by the Company. Once received, a member of the credit administration department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On an annual basis, the Company compares the actual selling price of collateral that has been sold to the most recent appraised value to determine what additional adjustment should be made to the appraisal value to arrive at fair value.

Loans Held For Sale: These loans are typically sold to an investor following loan origination and the fair value of such accounts are readily available based on direct quotes from investors or similar transactions experienced in the secondary loan market. Fair value adjustments, as well as realized gains and losses are recorded in current earnings. Fair value is determined by market prices for similar transactions adjusted for specific attributes of that loan (Level 2).

Assets and liabilities measured at fair value on a recurring basis, including financial assets and liabilities for which the Company has elected the fair value option, are summarized below:

Fair Value Measurements at December 31, 2017 Using:			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Treasury	\$ —	\$228,909	\$ —
U.S. government sponsored entities and agencies	—	19,961	—
Mortgage-backed securities: residential	—	632,566	—
Mortgage-backed securities: commercial	—	5,074	—
State and political subdivisions	—	113,370	—
Total securities available for sale	\$ —	\$999,881	\$ —
Loans held for sale	\$ —	\$ 12,024	\$ —
Mortgage banking derivatives	\$ —	\$ 175	\$ —
Financial Liabilities			
Mortgage banking derivatives	\$ —	\$ 35	\$ —

Fair Value Measurements at December 31, 2016 Using:			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets			
Securities available for sale			
Mortgage-backed securities-residential	\$ —	\$607,085	\$ —
Mortgage-backed securities-commercial	—	19,334	—
State and political subdivisions	—	128,336	—
Total securities available for sale	\$ —	\$754,755	\$ —
Loans held for sale	\$ —	\$ 23,699	\$ —
Mortgage banking derivatives	\$ —	\$ 229	\$ —
Financial Liabilities			
Mortgage banking derivatives	\$ —	\$ 66	\$ —

At December 31, 2017, the unpaid principal balance of loans held for sale was \$11,681, resulting in an unrealized gain of \$343 included in gains on sale of loans. None of these loans are 90 days or more past due or on nonaccrual as of December 31, 2017. At December 31, 2016, the unpaid principal balance of loans held for sale was \$23,457, resulting in an unrealized gain of \$242 included in gains on sale of loans.

There were no transfers between levels during 2017 and 2016.

At December 31, 2017 and 2016, there was one collateral dependent impaired loan carried at fair value of \$1,831, and \$1,650, respectively.

Foreclosed assets measured at fair value less costs to sell, had a net carrying amount of \$1,503 and \$0 as of December 31, 2017 and 2016, respectively. There were no properties at December 31, 2017 that had required write-downs to fair value resulting in no write downs for the year ended December 31, 2016.

The carrying amounts and estimated fair values of financial instruments, at December 31, 2017 and 2016 are as follows:

	Carrying Amount	Level 1	Fair Value Measurements at December 31, 2017 Using:		Total
			Level 2	Level 3	
<b>Financial assets</b>					
Cash and cash equivalents	\$ 251,543	\$ 251,543	\$ —	\$ —	\$ 251,543
Securities available for sale	999,881	—	999,881	—	999,881
Certificates of deposit held at other financial institutions	2,855	—	2,855	—	2,855
Securities held to maturity	214,856	—	217,608	—	217,608
Loans held for sale	12,024	—	12,024	—	12,024
Net loans	2,235,361	—	—	2,230,607	2,230,607
Restricted equity securities	18,492	n/a	n/a	n/a	n/a
Servicing rights, net	3,620	—	—	5,089	5,089
Accrued interest receivable	11,947	73	5,724	6,150	11,947
<b>Financial liabilities</b>					
Deposits	\$3,167,228	\$1,911,928	\$ 1,224,041	\$ —	\$3,135,969
Federal funds purchased and repurchase agreements	31,004	—	31,004	—	31,004
Federal Home Loan Bank advances	272,000	—	270,311	—	270,311
Subordinated notes	58,515	—	—	59,951	59,951
Accrued interest payable	2,769	51	2,030	688	2,769
<b>Financial assets</b>					
Fair Value Measurements at December 31, 2016 Using:					
	Carrying Amount	Level 1	Level 2	Level 3	Total
<b>Financial assets</b>					
Cash and cash equivalents	\$ 90,927	\$ 90,927	\$ —	\$ —	\$ 90,927
Securities available for sale	754,755	—	754,755	—	754,755
Certificates of deposit held at other financial institutions	1,055	—	1,055	—	1,055
Securities held to maturity	228,894	—	227,892	—	227,892
Loans held for sale	23,699	—	23,699	—	23,699
Net loans	1,757,039	—	—	1,727,188	1,727,188
Restricted equity securities	11,843	n/a	n/a	n/a	n/a
Servicing rights, net	3,621	—	—	5,015	5,015
Accrued interest receivable	9,931	—	5,172	4,759	9,931
<b>Financial liabilities</b>					
Deposits	\$2,391,818	\$1,551,461	\$ 836,444	\$ —	\$2,387,905
Federal funds purchased and repurchase agreements	83,301	—	83,301	—	83,301
Federal Home Loan Bank advances	132,000	—	131,098	—	131,098
Subordinated notes	58,337	—	—	61,762	61,762
Accrued interest payable	1,924	154	1,075	695	1,924

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

**(a) Cash and Cash Equivalents:** The carrying amounts of cash and short-term instruments approximate fair values and are classified as Level 1.

**(b) Loans:** Fair values of loans, excluding loans held for sale, are estimated as follows: For variable rate loans that repriced frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described previously. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

**(c) Restricted Equity Securities:** It is not practical to determine the fair value of Federal Home Loan Bank or Federal Reserve Bank stock due to restrictions placed on its transferability.

**(d) Mortgage Servicing Rights:** Fair value of mortgage servicing rights is based on valuation models that calculate the present value of estimated net cash flows based on industry market data. The valuation model incorporates assumptions that market participants would use in estimating future net cash flows resulting in a Level 3 classification.

**(e) Deposits:** The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in a Level 1 classification. The carrying amounts of fixed-term money market accounts approximate their fair values at the reporting date resulting in a Level 1 classification. Fair values for certificates of deposit are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

**(f) Federal Funds Purchased and Repurchase Agreements:** The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings, generally maturing within ninety days, approximate their fair values resulting in a Level 2 classification.

**(g) Federal Home Loan Bank Advances:** The fair values of the Company's long-term borrowings are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

**(h) Accrued Interest Receivable/Payable:** The carrying amounts of accrued interest approximate fair value resulting in a Level 1, Level 2 or Level 3 classification based on the asset/liability with which they are associated.

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

#### NOTE 17 – MORTGAGE BANKING DERIVATIVES

Commitments to fund certain mortgage loans (interest rate locks) to be sold into the secondary market and forward commitments for the future delivery of mortgage loans to third party investors are considered derivatives. It is the Company's practice to enter into forward commitments for the future delivery of residential mortgage loans when interest rate lock commitments are entered into in order to economically hedge the effect of changes in interest rates resulting from its commitments to fund the loans. These mortgage banking derivatives are not designated as hedge relationships. At year-end 2017, the Company had approximately \$21,656 of interest rate lock commitments and approximately \$35,566 of forward commitments for the future delivery of residential mortgage loans. The fair value of these mortgage banking derivatives was reflected by a derivative asset and liability of \$175 and \$35, respectively, at December 31, 2017. At year-end 2016, the Company had approximately \$42,689 of interest rate lock commitments and approximately \$50,955 of forward commitments for the future delivery of residential mortgage loans. The fair value of these mortgage banking derivatives was reflected by a derivative asset and liability of \$229 and \$66, respectively, at December 31, 2016. Fair values were estimated based on changes in mortgage interest rates from the date of the commitments. Changes in the fair values of these mortgage-banking derivatives are included in net gains on sale of loans.

The net gains (losses) relating to free-standing derivative instruments used for risk management is summarized below:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Forward contracts related to mortgage loans held for sale and interest rate contracts	\$ 32	\$ (37)	\$103
Interest rate contracts for customers	(54)	(182)	126

The following table reflects the amount and fair value of mortgage banking derivatives included in the consolidated balance sheet as of December 31, 2017 and 2016:

	2017		2016	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Included in other assets (liabilities):				
Interest rate contracts for customers	\$21,656	\$ 175	\$42,689	\$ 229
Forward contracts related to mortgage loans held for sale	\$35,566	\$ (35)	\$50,955	\$ (66)

#### NOTE 18 – LOAN COMMITMENTS AND OTHER RELATED ACTIVITIES

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance-sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

The contractual amounts of financial instruments with off-balance-sheet risk at year end were as follows:

	2017		2016	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Commitments to make loans	\$ 21,656	\$ —	\$ 42,689	\$ —
Unused lines of credit	124,997	480,184	179,096	336,891
Standby letters of credit	9,223	36,401	8,581	16,413

Commitments to make loans are generally made for periods of over 365 days. The fixed rate loan commitments have interest rates ranging from 2.50% to 12.00% and maturity terms ranging from less than 1 year to 30 years.

#### NOTE 19 – PREFERRED STOCK

In 2011, the Company issued 10,000 shares of preferred stock series A as part of its participation in the Small Business Lending Fund (“SBLF”), when the Company entered into a Small Business Lending Fund Securities Purchase Agreement (“SBLF Purchase Agreement”) with the United States Department of the Treasury (“Treasury”). On March 25, 2016, the Company redeemed the Series A preferred stock that had been issued to the Treasury, and as a result, the Company had no preferred stock issued and outstanding at December 31, 2017 or December 31, 2016.

#### NOTE 20 – PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION

Condensed financial information of Franklin Financial Network, Inc. follows:

#### CONDENSED BALANCE SHEETS

	December 31,	
	2017	2016
ASSETS		
Cash and cash equivalents	\$ 5,958	\$ 4,366
Investment in banking subsidiaries	358,833	325,571
Investment in other subsidiaries	2,393	1,363
Other assets	235	963
Total assets	<u>\$367,419</u>	<u>\$332,263</u>

	December 31,	
	2017	2016
<b>LIABILITIES AND EQUITY</b>		
Subordinated notes	\$ 58,515	\$ 58,337
Accrued expenses and other liabilities	4,354	3,668
Shareholders' equity	<u>304,550</u>	<u>270,258</u>
Total liabilities and shareholders' equity	<u>\$367,419</u>	<u>\$332,263</u>

#### CONDENSED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	Years ended December 31,		
	2017	2016	2015
Dividends from subsidiaries	\$ 4,000	\$ 2,050	\$ 150
Other income	171	305	488
Interest expense	4,321	2,902	—
Other expense	<u>2,890</u>	<u>2,842</u>	<u>2,270</u>
Loss before income tax and undistributed subsidiaries income	(3,040)	(3,389)	(1,632)
Income tax benefit	(2,671)	(2,320)	(689)
Equity in undistributed subsidiaries income	<u>28,468</u>	<u>29,126</u>	<u>17,023</u>
Net income	<u>\$28,099</u>	<u>\$28,057</u>	<u>\$16,080</u>
Comprehensive income	<u>\$29,997</u>	<u>\$20,895</u>	<u>\$13,584</u>

#### CONDENSED STATEMENTS OF CASH FLOWS

	Years ended December 31,		
	2017	2016	2015
Cash flows from operating activities			
Net income	\$28,099	\$ 28,057	\$16,080
Adjustments:			
Equity in undistributed subsidiaries income	(28,468)	(29,126)	(17,023)
Excess tax benefit related to the exchange of stock options	—	—	(279)
Amortization of debt issuance costs	178	124	—
Stock-based compensation	219	105	45
Compensation expense related to common stock issued to 401(k) plan	—	—	14
Change in other assets	728	(34)	(629)
Change in other liabilities	<u>686</u>	<u>3,058</u>	<u>463</u>
Net cash from operating activities	<u>1,442</u>	<u>2,184</u>	<u>(1,329)</u>
Cash flows from investing activities			
Investments in subsidiaries	<u>(1,359)</u>	<u>(116,850)</u>	<u>(49,809)</u>
Net cash from investing activities	<u>(1,359)</u>	<u>(116,850)</u>	<u>(49,809)</u>
Cash flows from financing activities			
Proceeds from other borrowings	—	10,000	—
Repayment of other borrowings	—	(10,000)	—
Proceeds from issuance of subordinated notes, net of issuance costs	—	58,213	—
Proceeds from exercise of common stock warrants	150	101	79
Proceeds from exercise of common stock options	1,615	1,571	1,834
Proceeds from issuance of common stock, net of offering costs	—	67,557	50,423

	Years ended December 31,		
	2017	2016	2015
Proceeds from subsidiaries related to issuance of common stock related to 401(k) plan	—	—	319
Divestment of common stock issued to 401(k) plan	(256)	(300)	—
Redemption of Series A preferred stock	—	(10,000)	—
Dividends paid on preferred stock	—	(23)	(100)
Net cash from financing activities	<u>1,509</u>	<u>117,119</u>	<u>52,555</u>
Net change in cash and cash equivalents	1,592	2,453	1,417
Beginning cash and cash equivalents	<u>4,366</u>	<u>1,913</u>	<u>496</u>
Ending cash and cash equivalents	<u>\$5,958</u>	<u>\$ 4,366</u>	<u>\$ 1,913</u>
Non-cash supplemental information:			
Transfers from subsidiary stock based compensation expense to parent company only additional paid-in capital	\$2,583	\$ 1,536	\$ 815

#### NOTE 21 – EARNINGS PER SHARE

The two-class method is used in the calculation of basic and diluted earnings per share. Under the two-class method, earnings available to common shareholders for the period are allocated between common shareholders and participating securities according to dividends declared (or accumulated) and participation rights in undistributed earnings. The factors used in the earnings per share computation follow:

	Years Ended December 31,		
	2017	2016	2015
<b>Basic</b>			
Net income available to common shareholders	\$ 28,083	\$ 28,034	\$ 15,980
Less: earnings allocated to participating securities	(219)	(284)	(174)
Net income allocated to common shareholders	<u>\$ 27,864</u>	<u>\$ 27,750</u>	<u>\$ 15,806</u>
Weighted average common shares outstanding including participating securities	13,145,005	10,933,095	9,885,233
Less: Participating securities	(102,650)	(110,628)	(107,923)
Average shares	<u>13,042,355</u>	<u>10,822,467</u>	<u>9,777,310</u>
Basic earnings per common share	<u>\$ 2.14</u>	<u>\$ 2.56</u>	<u>\$ 1.62</u>
<b>Diluted</b>			
Net income allocated to common shareholders	\$ 27,864	\$ 27,750	\$ 15,806
Weighted average common shares outstanding for basic earnings per common share	13,042,355	10,822,467	9,777,310
Add: Dilutive effects of assumed exercises of stock options	633,738	655,485	491,318
Add: Dilutive effects of assumed exercises of stock warrants	1,578	12,667	13,581
Average shares and dilutive potential common shares	<u>13,677,671</u>	<u>11,490,619</u>	<u>10,282,209</u>
Dilutive earnings per common share	<u>\$ 2.04</u>	<u>\$ 2.42</u>	<u>\$ 1.54</u>

Average stock options of 285,706, 165,232, and 245,992 shares of common stock were not considered in computing diluted earnings per common share for the year ended December 31, 2017, 2016, and 2015, respectively, because they were antidilutive.



## NOTE 22 - CAPITAL OFFERING

The Company completed a secondary public offering of its common stock on November 21, 2016. The Company issued 2,242,500 shares of common stock at a price of \$32.00 per share. Net proceeds were as follows:

Gross proceeds	\$71,760
Less: Stock offering costs	<u>(4,203)</u>
Net proceeds from issuance of common stock	<u>\$67,557</u>

The proceeds of the offering were used to provide capital to Franklin Synergy Bank to support continued growth and for general corporate purposes.

## NOTE 23 – QUARTERLY FINANCIAL RESULTS (UNAUDITED)

The following table provides a summary of selected consolidated quarterly financial data for the years ended December 31, 2017 and 2016:

	2017				2016			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter†	Second Quarter†	First Quarter†
<b>Income Statement Data (\$):</b>								
Interest income	\$35,121	\$33,780	\$33,011	\$30,541	\$27,336	\$ 25,724	\$ 24,286	\$ 22,561
Interest expense	10,513	9,454	8,542	6,898	5,637	5,049	4,352	3,285
Net interest income	24,608	24,326	24,469	23,643	21,699	20,675	19,934	19,276
Provision for loan losses	1,295	590	573	1,855	1,145	1,392	1,567	1,136
Noninterest income	3,264	3,569	3,880	4,008	2,553	4,876	4,626	3,085
Noninterest expense	15,987	15,278	15,283	14,276	13,229	13,708	12,913	11,831
Net income before taxes	10,590	12,027	12,493	11,520	9,878	10,451	10,080	9,394
Income tax expense	8,188	3,138	3,619	3,586	2,699	3,314	2,572	3,161
Net income	2,402	8,889	8,874	7,934	7,179	7,137	7,508	6,233
Net income available to common shareholders	2,394	8,889	8,866	7,934	7,179	7,137	7,508	6,210
<b>Earnings per share, basic</b>	<b>\$ 0.18</b>	<b>\$ 0.67</b>	<b>\$ 0.68</b>	<b>\$ 0.61</b>	<b>\$ 0.61</b>	<b>\$ 0.67</b>	<b>\$ 0.70</b>	<b>\$ 0.59</b>
<b>Earnings per share, diluted</b>	<b>\$ 0.17</b>	<b>\$ 0.65</b>	<b>\$ 0.64</b>	<b>\$ 0.58</b>	<b>\$ 0.58</b>	<b>\$ 0.63</b>	<b>\$ 0.66</b>	<b>\$ 0.55</b>

† The Company adopted Accounting Standard Update 2016-09 during the fourth quarter of 2016, and as a result, the amounts presented for income tax expense, net income, net income available to common shareholders and earnings per share have been adjusted accordingly and will not agree with the Company's Form 10-Q filings for these quarters. The adoption of ASU 2016-09 impacted previously reported quarterly earnings and/or earnings per share in 2016, as follows: (1) first quarter 2016 – no tax benefit was recorded; decreased diluted earnings per share by \$0.01; (2) second quarter 2016 – decreased income tax expense by \$509 and increased diluted earnings per share by \$0.04; and (3) third quarter 2016 – decreased income tax expense by \$107 and increased diluted earnings per share by \$0.01.

**Subsidiaries of the Registrant**

<b>Name</b>	<b>Jurisdiction of Organization</b>
Franklin Synergy Bank	Tennessee
Franklin Synergy Investments of Nevada, Inc.	Nevada
Franklin Synergy Investments of Tennessee, Inc.	Tennessee
Franklin Synergy Preferred Capital, Inc.	Nevada
Franklin Synergy Risk Management, Inc.	Tennessee

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in Registration Statement No. 333-220310 on Form S-8, Registration Statements No. 333-208265, No. 333-208578, and No. 333-220309 on Form S-3, and Registration Statement No. 333-214629 on Form S-3MEF of Franklin Financial Network, Inc. of our report dated March 16, 2018 relating to the financial statements, appearing in this Annual Report on Form 10-K.

/s/ Crowe Horwath LLP

Franklin, Tennessee  
March 16, 2018

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER  
PURSUANT TO RULE 13a-14(a) UNDER  
THE SECURITIES EXCHANGE ACT OF 1934**

I, Richard E. Herrington, certify that:

1. I have reviewed this Annual Report on Form 10-K for the fiscal year ended December 31, 2017 of Franklin Financial Network, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statement made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 16, 2018

By: /s/ Richard E. Herrington

Richard E. Herrington  
Chief Executive Officer

**CERTIFICATION OF CHIEF FINANCIAL OFFICER  
PURSUANT TO RULE 13a-14(a) UNDER  
THE SECURITIES EXCHANGE ACT OF 1934**

I, Sarah Meyerrose, certify that:

1. I have reviewed this Annual Report on Form 10-K for the fiscal year ended December 31, 2017 of Franklin Financial Network, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statement made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 16, 2018

By: /s/ Sarah Meyerrose

Sarah Meyerrose  
Chief Financial Officer

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND  
CHIEF FINANCIAL OFFICER PURSUANT TO RULE 13a-14(b) UNDER  
THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 1350 OF  
CHAPTER 63 OF TITLE 18 OF THE UNITED STATES CODE**

Each of the undersigned, Richard E. Herrington and Sarah Meyerrose, certifies, pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 (the “Exchange Act”) and Section 1350 of Chapter 63 of Title 18 of the United States Code, that (1) this Annual Report on Form 10-K for the year ended December 31, 2017 of Franklin Financial Network, Inc. (the “Company”) fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act, and (2) the information contained in this report fairly presents, in all material respects, the financial condition and results of operations of the Company.

This Certification is signed on March 16, 2018.

/s/ Richard E. Herrington

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Richard E. Herrington  
Chief Executive Officer

/s/ Sarah Meyerrose

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Sarah Meyerrose  
Chief Financial Officer

## Company Information

### BOARD OF DIRECTORS

**Richard E. Herrington**  
Chairman

**James E. Allen**  
Director

**James W. Cross, IV**  
Director

**Paul M. Pratt**  
Director

**Pamela J. Stephens**  
Director

**Melody J. Sullivan**  
Director

**Gregory E. Waldron**  
Director

**Benjamin P. Wynd**  
Director

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### Corporate Office

Franklin Financial Network, Inc.  
722 Columbia Avenue  
Franklin, Tennessee 37064  
615-236-2265

### Annual Shareholders' Meeting

The annual meeting of shareholders will be held on Thursday, May 24, 2018, at 9:30 a.m., Central Time, in the Musgrove Auditorium at the Company's corporate office.

### Registrar and Transfer Agent

Computershare Investor Services  
462 South 4th Street, Suite 1600  
Louisville, KY 40202  
[www-us.computershare.com/investor/](http://www-us.computershare.com/investor/)

### Shareholder Inquiries and Availability of Form 10-K Report

A copy of the Company's Annual Report on Form 10-K for the year ended December 31, 2017, (without exhibits) is available without charge to shareholders upon written request to the Corporate Secretary at the Company's corporate office.



Franklin Financial Network, Inc.  
722 Columbia Avenue  
Franklin, Tennessee 37064  
615-236-2265