



2017

DELIVERING ON  
OUR STRATEGY

ANNUAL REPORT  
AND FORM 10-K

 National Bank Holdings  
CORPORATION



NBH Bank



Bank Midwest



Community Banks  
of Colorado



Hillcrest Bank



National Bank Holdings  
CORPORATION®

## 2017 HIGHLIGHTS

### PROGRESSING TOWARD PROFITABILITY TARGETS:

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- ▶ Steadily increased earnings per share, return on average tangible equity and return on average tangible assets (adjusted for 2017 non-cash deferred tax asset charge)
- ▶ Grew originated loan balances 15% during the year, or \$386 million
- ▶ Relationship banking focused strategies delivered record new commercial loan originations of \$605 million, a 21.5% increase over 2016
- ▶ Grew Q4 2017 average transaction deposits 10% year-over-year, adjusted for four banking centers divested in 2017

### DISCIPLINED CAPITAL MANAGEMENT:

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- ▶ Generated industry-leading stock performance, delivering cumulative 3-year total shareholder return of 72%, with a year-end share price of \$32.43
- ▶ Steadily increased dividend to \$0.09 per share, an 80% increase in past 2 years
- ▶ Lifetime repurchases of 51% of shares at a weighted average price of \$20.03
- ▶ Closed accretive \$146 million acquisition of Peoples, Inc. on January 1, 2018, adding meaningful scale in our attractive markets, a best-in-class residential banking platform, a low-cost deposit base and a complementary loan portfolio

### DELIVERING EFFICIENCY INITIATIVES:

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- ▶ Continued trend of strong expense management, decreasing expenses 36% during the past five years, adjusted for acquisition expenses
- ▶ Reduced problem asset workout expenses while delivering consistent returns on acquired problem assets
- ▶ Divested another four banking centers in 2Q 2017, bringing total divestitures/consolidations to 17, or 17% of the franchise, since mid-2015
- ▶ Continued year-over-year progress towards 60% efficiency ratio target
- ▶ Streamlined our deposit products to deliver common sense solutions to our valued clients

### POSITIONED FOR CONTINUED GROWTH:

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- ▶ Strong, low-risk balance sheet poised for future growth
- ▶ Decreasing trend of non-performing and classified assets. Excluding acquired problem assets, non-performing asset ratio at 0.60% at December 31, 2017
- ▶ Continued to consolidate or divest underperforming banking centers while growing low-cost transaction deposits
- ▶ Peoples acquisition adds significant residential banking products, servicing capabilities and residential loan origination channels, accelerating non-interest income growth
- ▶ Enhanced awareness of our family of brands by launching upgraded web sites and multi-channel marketing initiatives, including an increase of digital and social media content

 **A LETTER FROM CHAIRMAN, PRESIDENT AND CEO**  
**TIM LANEY**

FELLOW SHAREHOLDERS,

During 2017, our Company made significant progress toward our long-term performance targets by leveraging our organic growth platforms to deliver on our commitments to our clients, our associates and to you, our shareholders. Our common sense approach to banking and our values-based culture have always guided our actions to improving our Company, and I am excited to share how this consistent approach impacted 2017's accomplishments.

We delivered earnings per share of \$1.26, a return on average tangible assets of 0.82% and a return on average tangible equity of 7.75%, all adjusted for tax-reform related charges and expenses related to our acquisition of Peoples, Inc. We originated a record \$605 million in commercial loans during 2017, a 21.5% increase over the prior year. Most importantly, those strong loan originations were the result of our focus on relationship-based banking, which also resulted in tremendous low-cost deposit growth. Our average quarterly transaction deposits grew 10% in the fourth quarter compared to the prior year fourth quarter, adjusting for the four banking centers we divested in 2017. Further, our client-funded balance sheet continues to improve as evidenced by the mix of transaction deposits to total deposits, improving 200 basis points to 72% as of December 31, 2017.

Our credit quality remains very strong as we moved past the energy portfolio issues in 2017 and recorded only 12 basis points non-energy net charge-offs on non 310-30 loans, compared to 10 basis points in 2016.

We also continued a strong trend of expense control, decreasing our total expenses 36% over the past five years, net of acquisition costs, while investing in key revenue generating initiatives. Several of those initiatives in 2017 led to the growth in bank card revenue and service charges of 5.3% compared to the prior year, and we expect these investments to result in future revenue growth in the years to come.

We are very pleased with our acquisition of Peoples, Inc., which closed on January 1, 2018, and was formally integrated into our organization during the first quarter of 2018. This transaction expands our community bank footprint in highly-attractive and geographically-relevant markets and adds a best-in-class, complementary residential banking platform to deepen our offering to clients. The addition of top banking talent, expanded residential banking products and a strong presence in new and attractive markets that strategically align to our core footprint have made this transaction a meaningful growth accelerator for our young Company.

With the acquisition of Peoples, we strengthened our coverage of the Colorado Front Range, including adding a meaningful presence in the rapidly growing market of Colorado Springs. Peoples also deepened our coverage and presence in the attractive Overland Park/Johnson County market in Kansas, added new presence in Lawrence, Kansas and adjacent areas, as well as new presence in Albuquerque and Taos, New Mexico. Our markets are a differentiator as Colorado has been cited as the 2nd strongest state economy in the U.S. with the Front Range contributing 96% of the population growth in recent years. Kansas City is not far behind, ranked as the 2nd best city for jobs and with consistently better demographic and economic statistics compared to the national average. Our Texas and New Mexico markets represent stable and growing markets as well.

We continued to invest in our clients during the year with the addition of a new, state-of-the art website and product enhancements across our digital, online and card-based platforms. Our investment extended into the communities we serve. For example, our 3rd annual Do More Charity Challenge event, co-founded by our organization, posted record-breaking fundraising results, driving our ability to contribute nearly \$750,000 to worthy non-profit organizations in our communities since the event's inception. We have demonstrated similar commitment, thought leadership and financial support in our other core market communities.

Taking care of our associates is also a priority, and we were especially pleased to reward over 50 percent of our teammates with a special \$1,000 bonus in connection with the 2017 tax-reform legislation. We also invested in a new intranet to better connect our associates and improve efficiencies in how they can partner to serve our clients every day. I want to especially thank our associates for their outstanding teamwork and diligence in delivering on a successful integration of the Peoples' team and clients, while also delivering on our organic growth commitment.

All of this translated into remarkable shareholder returns as we generated an industry-leading cumulative 3-year shareholder return of 72%, with a year-end share price of \$32.43. We also continued our commitment to shareholder returns by increasing our dividend to \$0.09 per share in 2017, representing an 80% increase in the past two years. Our capital position remains a strength, ending the year at almost 10% leverage capital and nearly 14% risk-based capital, providing capacity for additional growth.

As I reflect on our performance this year, the tremendous growth our Company has achieved in a very short period of time is remarkable. We've accomplished these results by consistently maintaining our focus on delivering value to our clients and communities, our associates and our shareholders. I firmly believe that the combination of our demonstrated organic growth engine, with complementary and accretive acquisitions, such as the Peoples transaction, all operating in highly attractive markets, provides a platform for continued industry-leading growth trajectory in 2018 and beyond.

SINCERELY,



TIM LANEY  
CHAIRMAN, PRESIDENT AND CEO

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**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

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-35654

**NATIONAL BANK HOLDINGS CORPORATION**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**27-0563799**  
(I.R.S. Employer  
Identification No.)

7800 East Orchard Road, Suite 300, Greenwood Village, Colorado 80111

(Address of principal executive offices) (Zip Code)

Registrant's telephone, including area code:  
(720) 529-3336

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

Title of each class  
Class A Common Stock, Par Value \$0.01

Name of each exchange on which registered  
New York Stock Exchange

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

None

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 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 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 definitions of "large accelerated filer", "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

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 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 shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of June 30, 2017, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was approximately \$866,000,000 based on the closing sale price as reported on the New York Stock Exchange.

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of February 22, 2018, NBHC had outstanding 30,312,222 shares of Class A voting common stock with \$0.01 par value per share, excluding 160,510 shares of restricted Class A common stock issued but not yet vested.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's definitive proxy statement for its 2018 Annual Meeting of Shareholders to be filed within 120 days of December 31, 2017 will be incorporated by reference into Part III of this form 10-K.

## INDEX

	<u>Page</u>
Cautionary Notes Regarding Forward Looking Statements	3
PART I	
Item 1. Business	5
Item 1A. Risk Factors	18
Item 1B. Unresolved Staff Comments	30
Item 2. Properties	30
Item 3. Legal Proceedings	30
Item 4. Mine Safety Disclosures	30
PART II	
Item 5. Market for Registrant’s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities	31
Item 6. Selected Financial Data	34
Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations	41
Item 7A. Quantitative and Qualitative Disclosures about Market Risk	72
Item 8. Financial Statements and Supplementary Data	73
Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	123
Item 9A. Controls and Procedures	123
Item 9B. Other Information	125
PART III	
Item 10. Directors, Executive Officers and Corporate Governance	125
Item 11. Executive Compensation	125
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters	125
Item 13. Certain Relationships and Related Transactions, and Director Independence	125
Item 14. Principal Accountant Fees and Services	125
PART IV	
Item 15. Exhibits and Financial Statement Schedules	126
Signatures	129

## CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, notwithstanding that such statements are not specifically identified. Any statements about our expectations, beliefs, plans, predictions, forecasts, objectives, assumptions or future events or performance are not historical facts and may be forward-looking. These statements are often, but not always, made through the use of words or phrases such as “anticipate,” “believe,” “can,” “would,” “should,” “could,” “may,” “predict,” “seek,” “potential,” “will,” “estimate,” “target,” “plan,” “project,” “continuing,” “ongoing,” “expect,” “intend” and similar words or phrases. These statements are only predictions and involve estimates, known and unknown risks, assumptions and uncertainties. We have based these statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, liquidity, results of operations, business strategy and growth prospects.

Forward-looking statements involve certain important risks, uncertainties and other factors, any of which could cause actual results to differ materially from those in such statements and, therefore, you are cautioned not to place undue reliance on such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to:

- our ability to execute our business strategy, as well as changes in our business strategy or development plans;
- business and economic conditions generally and in the financial services industry;
- economic, market, operational, liquidity, credit and interest rate risks associated with our business;
- effects of any changes in trade, monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board;
- changes imposed by regulatory agencies to increase our capital to a level greater than the current level required for well-capitalized financial institutions;
- effects of inflation, as well as, interest rate, securities market and monetary supply fluctuations;
- changes in the economy or supply-demand imbalances affecting local real estate values;
- changes in consumer spending, borrowings and savings habits;
- with respect to our mortgage business, our inability to negotiate our fees with Fannie Mae, Freddie Mac, Ginnie Mae or other investors for the purchase of our loans, our obligation to indemnify purchasers or to repurchase the related loans if they fail to meet certain criteria, or higher rate of delinquencies and defaults as a result of the geographic concentration of our servicing portfolio;
- our ability to identify potential candidates for, obtain regulatory approval for, and consummate, acquisitions or consolidations of financial institutions on attractive terms, or at all;
- our ability to integrate acquisitions or consolidations and to achieve synergies, operating efficiencies and/or other expected benefits within expected time-frames, or at all, or within expected cost projections, and to preserve the goodwill of acquired financial institutions;
- our ability to realize the anticipated benefits from enhancements or updates to our core operating systems from time to time without significant change in our client service or risk to our control environment;
- our dependence on information technology and telecommunications systems of third party service providers and the risk of system failures, interruptions or breaches of security, including those that could result in disclosure or misuse of confidential or proprietary client or other information;
- our ability to achieve organic loan and deposit growth and the composition of such growth;



- changes in sources and uses of funds, including loans, deposits and borrowings;
- increased competition in the financial services industry, nationally, regionally or locally, resulting in, among other things, lower returns;
- continued consolidation in the financial services industry;
- our ability to maintain or increase market share and control expenses;
- the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters;
- the trading price of shares of the Company's stock;
- the effects of tax legislation or challenges to our tax position;
- our ability to realize deferred tax assets or the need for a valuation allowance, or the effects of changes in tax laws on our deferred tax assets;
- costs and effects of changes in laws and regulations and of other legal and regulatory developments, including, but not limited to, changes in regulation that affect the fees that we charge, the resolution of legal proceedings or regulatory or other governmental inquiries, and the results of regulatory examinations, reviews or other inquiries; and changes in regulations that apply to us as a Colorado state-chartered bank;
- technological changes;
- the timely development and acceptance of new products and services and perceived overall value of these products and services by our clients;
- changes in our management personnel and our continued ability to hire and retain qualified personnel;
- ability to implement and/or improve operational management and other internal risk controls and processes and our reporting system and procedures;
- regulatory limitations on dividends from our bank subsidiary;
- changes in estimates of future loan reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements;
- widespread natural and other disasters, dislocations, political instability, acts of war or terrorist activities, cyberattacks or international hostilities through impacts on the economy and financial markets generally or on us or our counterparties specifically;
- a cyber-security incident, data breach or a failure of a key information technology system;
- impact of reputational risk on such matters as business generation and retention;
- other risks and uncertainties listed from time to time in the Company's reports and documents filed with the Securities and Exchange Commission; and
- our success at managing the risks involved in the foregoing items.

Any forward-looking statement speaks only as of the date on which it is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events or circumstances, except as required by applicable law.



## **PART I: FINANCIAL INFORMATION**

### **Item 1. BUSINESS.**

#### **Summary**

National Bank Holdings Corporation ("NBHC" or the "Company") is a bank holding company that was incorporated in the State of Delaware in 2009 and is headquartered immediately south of Denver, in Greenwood Village, Colorado. Our primary operations are conducted through our wholly owned subsidiary, NBH Bank, referred to as the "Bank", or "NBH Bank", through which we provide a variety of banking products to both commercial and consumer clients. We service our clients through a network of 85 banking centers as of December 31, 2017, with the majority of those banking centers located in Colorado and the greater Kansas City region, and through online and mobile banking products and services. The Peoples, Inc. acquisition adds an additional 19 banking centers, with the majority of those banking centers located in Colorado and the greater Kansas City region. As of December 31, 2017, we had \$4.8 billion in assets, \$3.2 billion in loans, \$4.0 billion in deposits and \$0.5 billion in shareholders' equity.

The Company was formed through a private offering of our common stock in 2009. As part of our goal of becoming a leading regional community bank holding company, we are pursuing a strategy of organic growth through strong banking relationships with small and medium-sized businesses and consumers in our markets, complemented by selective acquisitions of financial institutions and other complementary businesses. Our long-term business model utilizes our organic development infrastructure, low-risk balance sheet, continuous operational development and a disciplined acquisition strategy to create value and provide attractive returns.

On October 9, 2015, we announced the termination of the operating agreement between our bank subsidiary, NBH Bank, N.A., and its primary regulator, the OCC. On December 31, 2015, NBH Bank, N.A. converted into a Colorado state-chartered bank while maintaining membership with the Federal Reserve Bank of Kansas City and we changed the legal name of NBH Bank, N.A. to NBH Bank. Through NBH Bank, we operate under the following brand names: Bank Midwest in Kansas and Missouri; Community Banks of Colorado in Colorado; and Hillcrest Bank in New Mexico and Texas. We believe that conducting our banking operations under a single state charter streamlines our operations and enables us to more effectively and efficiently execute our growth strategy.

#### **Our Acquisitions**

In October 2010, we acquired the failed Hillcrest Bank from the FDIC and began banking operations. As of December 31, 2017, we have completed five bank acquisitions, three of which were FDIC-assisted. All loss share agreements associated with the FDIC-assisted acquisitions were terminated on November 5, 2015. We have transformed these five banks into one collective banking operation with strong organic growth, prudent underwriting, and meaningful market share with continued opportunity for expansion. We believe that we have established critical mass in our current markets and have structured acquisitions that limit our credit risk, which positions us for attractive returns.

The following table summarizes certain highlights of our five historic acquisitions, including deposits and assets at fair value as of each acquisition date:

	<u>Pine River</u>	<u>Community Banks of Colorado</u>	<u>Bank of Choice</u>	<u>Bank Midwest</u>	<u>Hillcrest Bank</u>
Date acquired	August 1, 2015	October 21, 2011	July 22, 2011	December 10, 2010	October 22, 2010
FDIC-assisted	No	Yes	Yes	No	Yes
Loss share	No	Yes <sup>(1)</sup>	No	No	Yes <sup>(2)</sup>
Banking centers <sup>(3)</sup>	4	40	16	39	9 (and 32 retirement centers)
Deposits (millions)	\$ 130	\$ 1,195	\$ 760	\$ 2,386	\$ 1,234
Assets (millions)	\$ 142	\$ 1,228	\$ 950	\$ 2,426	\$ 1,377
Primary Market	Colorado	Colorado	Colorado	Greater Kansas City Region	Greater Kansas City Region

(1) Commercial loss-share agreement (terminated November 5, 2015).

(2) Single Family loss-share agreement and Commercial Shared-Loss Agreement (terminated November 5, 2015).

(3) During 2013, four California banking centers acquired with the Community Banks of Colorado acquisition and 32 retirement centers acquired with the Hillcrest Bank acquisition were closed. During 2015, three banking centers were consolidated in our Bank Midwest network. During 2016, seven banking centers were consolidated in our Community Banks of Colorado network. During 2017, six banking centers were consolidated or sold in our Bank Midwest and Community Banks of Colorado networks.

### *Peoples Acquisition*

During the second quarter of 2017, the Company announced the acquisition of Peoples, Inc. (“Peoples”), the bank holding company of Colorado-based Peoples National Bank and Kansas-based Peoples Bank. The acquisition closed on January 1, 2018 and strengthens the NBH franchise in the attractive and growing markets along the Colorado Front Range, the greater Kansas City region, including expanding our existing Overland Park, Kansas market and extending into the college town markets of Lawrence and Ottawa, Kansas, and expands the NBH franchise into New Mexico. The transaction is valued at \$146.4 million, including \$36.2 million of cash consideration, and adds an estimated \$868 million in assets, \$544 million in loans held for investment and \$730 million of low cost deposits. Peoples’ complementary, franchise-centric, retail mortgage platform adds significant capabilities with over \$1 billion in mortgage production historically and primarily serving NBH’s markets with additional mortgage offices in Arizona, California, Nevada and Utah. The acquisition adds a solid core deposit base, expanding into New Mexico, with cost of deposits significantly below peers at 0.10%. The system conversion was completed during the first quarter of 2018. Refer to note 24 – Subsequent Events of our consolidated financial statements for additional details of the acquisition.

All of our acquisitions were accounted for under the acquisition method of accounting, and accordingly, all assets acquired and liabilities assumed were recorded at their respective acquisition date fair values and the fair value discounts/premiums on loans are being accreted over the lives of the loans.

### **Our Market Area**

Our core markets are broadly defined as Colorado and the greater Kansas City region. We are the fifth largest banking center network among Colorado-based banks and the fifth largest banking center network in the greater Kansas City MSA ranked by deposits as of June 30, 2017 (the last date as of which data are available), according to S&P Global. Other major MSAs in which we operate include Dallas-Fort Worth-Arlington, Texas and Austin-Round Rock, Texas.

We believe that our established presence positions us well for growth opportunities in our markets. An integral component of our foundation and growth strategy has been to capitalize on market opportunities and acquire financial services franchises. Our primary focus has been on markets that we believe are characterized by some or all of the following: (i) attractive demographics with household income and population growth above the national average; (ii) concentration of business activity; (iii) high quality deposit bases; (iv) an advantageous competitive landscape that provides opportunity to achieve meaningful market presence; (v) consolidation opportunities as well as potential for add-on transactions; and (vi) markets sizeable enough to support our long-term organic growth objectives.

The table below describes certain key demographic statistics regarding our markets:

	<u>Deposits (billions)</u>	<u># of businesses (thousands)</u>	<u>Population (millions)</u>	<u>Unemployment rate<sup>(1)</sup></u>	<u>Population growth<sup>(2)</sup></u>	<u>Median household income</u>	<u>Top 3 competitor combined deposit market share</u>
Denver, CO	\$ 78.5	114.9	2.9	2.8%	15.3%	\$ 75,489	55%
Front Range, CO <sup>(3)</sup>	107.8	182.7	4.6	2.8%	15.2%	73,719	53%
Kansas City, MO-KS MSA	51.0	76.0	2.1	3.2%	6.0%	65,702	43%
U.S.				3.9%	5.8%	61,045	55% <sup>(4)</sup>

(1) Unemployment data is as of November 30, 2017.

(2) For the period 2010 through 2017.

(3) CO Front Range is a population weighted average of the following Colorado MSAs: Denver, Boulder, Colorado Springs, Fort Collins and Greeley.

(4) Based on U.S. Top 20 MSAs (determined by population).

Source: S&P Global as of December 31, 2017, except Deposits and Top 3 Competitor Combined Deposit Market Shares, which reflects data as of June 30, 2017.

## Our Business Strategy

As part of our goal of becoming a leading regional community bank holding company, we seek to continue to generate strong organic growth, as well as pursue selective acquisitions of financial institutions and other complementary businesses. Our focus is on building organic growth through strong banking relationships with small- and medium-sized businesses and consumers in our primary markets, while maintaining a low-risk profile designed to generate reliable income streams and attractive returns. We view our core market areas as the greater Kansas City region and Colorado. The key components of our strategic plan are:

- *Focus on client-centered, relationship-driven banking strategy.* Our small business and commercial bankers focus on small and medium-sized businesses with an advisory approach that emphasizes understanding the client's business and offering a complete array of loan, deposit and treasury management products and services. Our business and commercial bankers are supported by treasury management teams in each of their markets, which allows us to more effectively deliver a comprehensive suite of products and services to our business clients and further deepen our banking relationships. Our consumer bankers focus on knowing their clients in order to best meet their financial needs, offering a full complement of loan, deposit, online and mobile banking solutions.
- *Expansion of commercial banking, business banking and specialty businesses.* We have made significant investments in our commercial relationship managers, as well as developed significant capabilities across our business banking and several specialty commercial banking offerings. Our strategy is to originate a high-quality loan portfolio that is diversified across industries and granular in loan size. We have preferred lender status with the Small Business Administration ("SBA") providing a leveraged platform for growth in the business lending segment. We believe we are well-positioned to leverage our operating and risk management infrastructure through organic growth and we intend to continue to add or repurpose our commercial relationship managers to higher growth opportunities and markets in order to drive increased profitability.
- *Expansion through organic growth and competitive product offerings.* We believe that our focus on serving consumers and small- to medium-sized businesses, coupled with our competitive product offerings, will provide an expanded revenue base and new sources of fee income. We conduct regular market and competitive analysis to determine which products and services are best suited for our clients. Our teams also continue to pursue opportunities to deepen client relationships, which we believe will further increase our organic loan origination volumes and attract new transaction accounts that offer lower cost of funds and higher fee generating activity.

- *Continue to strengthen profitability through organic growth and operating efficiencies.* We continue to utilize our comprehensive underwriting and risk management processes under one operating platform while maintaining local branding, leadership and decision making, which allows us to support growth and realize operating efficiencies throughout our enterprise. The actions taken to consolidate banking centers in conjunction with other expense management initiatives have resulted in significant cost savings. We believe that we have the infrastructure in place to support our future revenue growth without causing non-interest expenses to increase by a corresponding amount. Our growth strategy is focused on organic initiatives in order to accelerate our growth in profitability. Key priorities to strengthen profitability include the continued ramp-up of loan production, growing low-cost core deposits, implementing additional fee-based business initiatives and further enhancing operational efficiencies.
- *Maintain conservative risk profile and sound risk management practices.* Strong risk management is an important element of our operating philosophy. We maintain a conservative risk culture with adherence to mature and seasoned policies across all areas of the organization. We implement self-imposed concentration limits on our loan portfolio to ensure a granular and diverse loan portfolio and protect against downside risk to any particular industry or real estate sector. Our risk management approach seeks to identify, assess and mitigate risk and minimize any resulting losses. We have implemented processes to identify measure, monitor, and report and analyze the types of risk to which we are subject. We believe our risk management policies establish appropriate limitations that allow for the prudent oversight of such risks that include, but are not limited to the following: credit, liquidity, market, operational, legal and compliance, reputational, and strategic and business risk.
- *Pursue disciplined acquisitions.* We expect that acquisitions will continue to be a component of our growth strategy and we intend to carefully select acquisition opportunities that we believe have stable core franchises, have significant local market share or will add asset generation capabilities or fee income streams while structuring the transactions to limit risk. Further, we seek transactions that offer opportunities for clear financial benefits with valuations that have acceptable levels of earnings accretion, tangible book value dilution/earn-back, and internal rates of return. We seek to acquire financial services franchises in markets that exhibit attractive demographic attributes and we believe that our focus on attractive markets will provide long-term opportunities for organic growth. Our focus is on our primary markets of Colorado, Missouri and Kansas, including teams, asset portfolios, specialty commercial finance businesses, and whole banks.

We believe our strategy of strong organic growth through the retention, expansion and development of client-centered relationships and growth through selective acquisitions in attractive markets provides flexibility regardless of economic conditions. We also believe that our established platform for assessing, executing and integrating acquisitions creates opportunities in an economic downturn while the combination of attractive market factors, franchise scale in our targeted markets and our relationship-centered banking focus creates opportunities in an improving economic environment.

## **Products and Services**

Through NBH Bank, our primary business is to offer a full range of traditional banking products and financial services to both our commercial, business and consumer clients, who are predominantly located in Colorado, the greater Kansas City region, New Mexico and Texas. We conduct our banking business through 85 banking centers, with 44 of those located in Colorado, 39 in Kansas and Missouri, and two in Texas as of December 31, 2017. Our distribution network also includes 106 ATMs as well as fully integrated online banking and mobile banking services. The Peoples acquisition adds 19 banking centers, with seven located in Kansas, six located in Colorado, and six located in New Mexico, and adds an additional 17 ATMs. We offer a high level of personalized service to our clients through our relationship managers and banking center associates. We believe that a banking relationship that includes multiple services, such as loan and deposit services, online and mobile banking solutions and treasury management products and services, is the key to profitable and long-lasting client relationships and that our local focus and decision making provide us with a competitive advantage over banks that do not have these attributes.

Our primary strategic objective is to serve small- to medium-sized businesses in our markets with a variety of unique and useful services, including a full array of banking products, while maintaining a strong and disciplined credit culture and delivering excellent client service. We offer a variety of products and services that are focused on the following areas:

## Commercial and Specialty Banking

Our commercial bankers focus on small- and medium-sized businesses with an advisory approach that emphasizes understanding the client's business and offering a complete suite of loan, deposit and treasury management products and services. We have invested significantly in our commercial banking capabilities, attracting experienced commercial bankers from competing institutions in our markets, which have resulted in significant growth in our originated loan portfolio. Our commercial relationship managers offer a wide range of commercial loan products, including:

***Commercial and Industrial Loans***—We originate commercial and industrial loans and leases, including working capital loans, equipment loans, lender finance loans, agriculture loans, government and non-profit loans, owner occupied commercial real estate loans and other commercial loans and leases. The terms of these loans vary by purpose and by type of underlying collateral, if any.

Working capital loans generally have terms of up to one year, are usually secured by accounts receivable and inventory and carry the personal guarantees of the principals of the business. Equipment loans are generally secured by the financed equipment at advance rates that we believe are appropriate for the equipment type. In the case of owner-occupied commercial real estate loans, we are usually the primary provider of financial services for the company and/or the principals and the primary source of repayment is through the cash flows generated by the borrowers' business operations. Owner-occupied commercial real estate loans are typically secured by a first lien mortgage on real property plus assignments of all leases related to the properties. Underwriting guidelines generally require borrowers to contribute cash equity that results in an 80% or less loan-to-value ratio on owner-occupied properties. As of December 31, 2017, substantially all of our commercial and industrial loans were secured.

***Non-Owner Occupied Commercial Real Estate Loans***—Non-owner occupied commercial real estate loans ("CRE") consist of loans to finance the purchase of commercial real estate, loans to support working capital needs of businesses that are secured by commercial real estate and construction and development loans. Our non-owner occupied CRE loans include loans on multi-family construction properties, commercial properties such as office buildings, retail centers, or free-standing commercial properties, multi-family and investor properties and raw land development loans.

Non-owner occupied CRE loans are typically secured by a first lien mortgage on multi-family, office, warehouse, hotel or retail property plus assignments of all leases related to the properties. Underwriting guidelines generally require borrowers to contribute cash equity that results in a 75% or less loan-to-value ratio.

We seek to reduce the risks associated with commercial mortgage lending by focusing our lending in our primary markets. Although non-owner occupied CRE is not a primary focus of our lending strategy, we have developed teams in each our markets of dedicated CRE bankers who possess the depth and breadth of both market knowledge and industry expertise, which serves to further mitigate risk of this product type.

***Small Business Administration Loans***—We offer a range of U.S. Small Business Administration, or SBA loans, to support manufacturers, distributors and service providers targeted to small businesses and entrepreneurs seeking growth capital, working capital, or other capital investments as an SBA Preferred Lender Provider. As a Preferred Lender Provider of the SBA, we are able to expedite SBA loan approval, closing, and servicing functions through delegated authority to underwrite and approve loans on behalf of the SBA. We utilize the SBA 7(a) loan, SBA 504 loan, SBA Express loan, and CAP Line loan programs.

***Commercial Deposit Products (including business online and mobile banking)***—Our commercial bankers are focused on providing value-added deposit products to our clients that optimizes their cash management program. We are focused on full-relationship banking, including banking core operating accounts and ancillary accounts. We also provide our commercial clients with money market accounts and short-term repurchase reserve accounts depending on their individual needs. In addition, we provide a wide array of treasury management solutions to our clients, including: business online and mobile banking, commercial credit card services, wire transfers, automated clearing house services, electronic bill payment, lock box services, remote deposit capture services, merchant processing services, cash vault, controlled disbursements, fraud prevention services through positive pay and other auxiliary services (including account reconciliation, collections, repurchase accounts, zero balance accounts and sweep accounts).

## Business and Consumer Banking

Our business and consumer bankers focus on knowing their clients in order to best meet their financial needs, offering a full complement of loan, deposit and online and mobile banking solutions. We strive to do business in the areas served by our banking centers, which is also where our marketing is focused, and the vast majority of our new loan and deposit clients are located in existing market areas.

All of our newly originated consumer loans are on a direct to consumer basis. We offer a variety of business and consumer loans, including:

***Business Loans***—Business loans consist of term loans, line of credit, and real estate secured loans. The terms of these loans vary by purpose and by type of underlying collateral, if any. Business loans generally require LTV ratios of not more than 75 percent. Business loans also assist in the growth of our deposits because many business loan borrowers establish noninterest-bearing and interest-bearing demand deposit accounts and treasury management relationships with us. Those deposit accounts help us to reduce our overall cost of funds and those treasury management relationships provide us with a source of non-interest income.

***Residential Real Estate Loans***—Residential real estate loans consist of loans secured by the primary or secondary residence of the borrower. These loans consist of closed loans, which are typically amortizing over a 10 to 30-year term. Our loan-to-value (LTV) benchmark for these loans will generally be below 80% at inception unless related to certain internal or government programs where higher LTV's may be warranted, along with satisfactory debt-to-income ratios. We do not originate or purchase negatively amortizing or sub-prime residential loans. These residential real estate loans are generally originated under terms and conditions consistent with secondary market guidelines. Some of these loans will be placed in the Bank's loan portfolio; however, a majority are sold in the secondary market and provide a significant source of fee income. The mortgage operation acquired from Peoples adds significant residential banking products, servicing capabilities and residential loan origination channels. In addition to the referral business through our existing consumer client base as we establish full banking relationships we have a dedicated team of mortgage bankers who focus origination efforts primarily on new purchase activity and secondarily on refinance activity. We also offer open- and closed-ended home equity loans, which are loans generally secured by second lien positions on residential real estate, and residential construction loans to consumers and builders for the construction of residential real estate.

***Consumer Loans***—Consumer loans are structured as small personal lines of credit and term loans, with the latter generally bearing interest at a higher rate and having a shorter term than residential mortgage loans. Consumer loans are both secured (for example by deposit accounts, brokerage accounts or automobiles) and unsecured and carry either a fixed rate or variable rate. Examples of our consumer loans include home improvement loans not secured by real estate, new and used automobile loans and personal lines of credit.

***Deposit Products (including online and mobile banking)***—We offer a variety of deposit products to our clients, including checking accounts, savings accounts, money market accounts and other deposit accounts, including fixed-rate, fixed maturity time deposits ranging in terms from 30 days to five years, and individual retirement accounts. We view deposits as an important part of the overall client relationship and believe they provide opportunities to cross-sell other products and services. We intend to continue our efforts to attract low-cost transaction deposits from our client relationships. Consumer deposit flows are significantly influenced by general and local economic conditions, changes in prevailing interest rates, internal pricing decisions and competition. Our deposits are primarily obtained from areas surrounding our banking centers. In order to attract and retain deposits, we rely on providing competitively priced high-quality service and introducing new products and services that meet our clients' needs.

We also offer comprehensive, user-friendly mobile and online banking platforms allowing our clients to pay bills, check statements, deposit checks and transfer funds, amongst other features, online or on-the-go.

## **Lending Activities**

Our loan portfolio includes commercial and industrial loans, commercial real estate loans, residential real estate loans, business loans and consumer loans. The principal risk associated with each category of loans we make is the creditworthiness of the borrower. Borrower creditworthiness is affected by general economic conditions and the attributes of the borrower's market or industry segment. Attributes of the relevant business market or industry segment include the economic and competitive environment, changes to supply or demand, threat of substitutes and barriers to entry and exit. In our credit underwriting process, we carefully evaluate the borrower's industry, operating performance, liquidity and financial condition. We underwrite credits based on multiple repayment sources, including operating cash flow, liquidation of collateral and guarantor support, where appropriate. We closely monitor the operating performance, liquidity and financial condition of borrowers through analysis of periodic financial statements and meetings with the borrower's management. As part of our credit underwriting process, we also review the borrower's total debt obligations on a global basis. Our credit policy requires that key risks be identified and measured, documented and mitigated, to the extent possible, to seek to ensure the soundness of our loan portfolio.

Our credit policy also provides detailed procedures for making loans to individual and business clients along with the regulatory requirements to ensure that all loan applications are evaluated subject to our fair lending policy. Our credit policy addresses the common credit standards for making loans to clients, the credit analysis and financial statement requirements, the collateral requirements, including insurance coverage where appropriate, as well as the documentation required. Our ability to analyze a borrower's current financial health and credit history, as well as the value of collateral as a secondary source of repayment, when applicable, are significant factors in determining the creditworthiness of loans to clients. We require various levels of internal approvals based on the characteristics of such loans, including the size, nature of the exposure and type of collateral, if any. We believe that the procedures required by our credit policies enhance internal responsibility and accountability for underwriting decisions and permit us to monitor the performance of credit decisioning. An integral element of our credit risk management strategy is the establishment and adherence to concentration limits for our portfolio. We have established concentration limits that apply to our portfolio based on product types such as commercial real estate, consumer lending, and various categories of commercial and industrial lending. For more detail on our credit policies, see "Management's Discussion and Analysis of Financial Condition and Results of Operations-Financial Condition-Asset Quality."

## **Competition**

The banking landscape in our primary markets of Colorado, Kansas, Missouri and Texas is highly competitive and quite fragmented, with many small banks having limited market share while the large out-of-state national and super-regional banks control the majority of deposits and profitable banking relationships. We compete actively with national, regional and local financial services providers, including: banks, thrifts, credit unions, mortgage companies, finance companies and financial technology ("FinTech") companies.

Competition among providers of financial products and services continues to increase, with consumers having the opportunity to select from a variety of traditional brick and mortar banks and nontraditional alternatives, such as online banks and FinTech companies. Competition among providers is based on many factors. The primary factors driving commercial and consumer competition for loans and deposits are interest rates, the fees charged, client service levels and the range of products and services offered. In addition, other competitive factors include the location and hours of our banking centers, the client service orientation of our associates and the availability of digital banking products and services. We believe the most important of these competitive factors that determine our success are our consumer bankers' focus on knowing their individual clients in order to best meet their financial needs and our business and commercial bankers' focus on small and medium-sized businesses with an advisory approach that emphasizes understanding the client's business and offering a complete array of loan, deposit and treasury management products and services through our banking centers and our digital banking platform.

We recognize that there are banks and other financial services companies with which we compete that have greater financial resources, access to more capital and higher lending capacity than we do and offer a wider range of deposit and lending instruments than we do. However, given our existing capital base, we expect to be able to meet the majority of small to medium-sized business and consumer credit and depository service needs.



## **Associates**

At December 31, 2017, we had 899 full-time associates and 64 part-time associates.

## **SUPERVISION AND REGULATION**

The U.S. banking industry is highly regulated under federal and state law. Banking laws, regulations, and policies affect the operations of the Company and its subsidiary. Investors should understand that the primary objective of the U.S. bank regulatory regime is the protection of depositors, the Depositors Insurance Fund (“DIF”), and the banking system as a whole, not the protection of the Company’s shareholders.

As a bank holding company, we are subject to inspection, examination, supervision and regulation by the Board of Governors of the Federal Reserve System (the “Federal Reserve”). Our bank subsidiary, NBH Bank, is a Colorado state-chartered bank and a member of the Federal Reserve Bank of Kansas City. As such, NBH Bank is subject to examination, supervision and regulation by both the Colorado Division of Banking and the Federal Reserve. In addition, we expect that any additional businesses that we may invest in or acquire will be regulated by various state and/or federal banking regulators.

Banking statutes and regulations are subject to continual review and revision by Congress, state legislatures and federal and state regulatory agencies. A change in such statutes or regulations, including changes in how they are interpreted or implemented, could have a material effect on our business. In addition to laws and regulations, state and federal bank regulatory agencies may issue policy statements, interpretive letters and similar written guidance pursuant to such laws and regulations, which are binding on us and our subsidiaries.

Banking statutes, regulations and policies could restrict our ability to diversify into other areas of financial services, acquire depository institutions and make distributions or pay dividends on our equity securities. They may also require us to provide financial support to any bank that we control, maintain capital balances in excess of those desired by management and pay higher deposit insurance premiums as a result of a general deterioration in the financial condition of NBH Bank, or other depository institutions we control.

The description below summarizes certain elements of the applicable bank regulatory framework. This description is not intended to describe all laws and regulations applicable to us and our subsidiaries. The description is qualified in its entirety by reference to the full text of the statutes, regulations, policies, interpretive letters and other written guidance that are described.

### **National Bank Holdings Corporation as a Bank Holding Company**

As a bank holding company, we are subject to regulation under the Bank Holding Company Act (“BHCA”) and to supervision, examination, and enforcement by the Federal Reserve. Federal Reserve jurisdiction also extends to any company that we may directly or indirectly control, such as non-bank subsidiaries and other companies in which we have a controlling interest. While subjecting us to supervision and regulation, we believe that our status as a bank holding company (as opposed to being a non-controlling investor) broadens the investment opportunities available to us among public and private financial institutions.

The BHCA generally prohibits a bank holding company from engaging, directly or indirectly, in activities other than banking or managing or controlling banks, except for activities determined by the Federal Reserve to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Provisions of the Gramm-Leach-Bliley Financial Modernization Act of 1999 (the “GLB Act”) expanded the permissible activities of a bank holding company that qualifies as a financial holding company. Under the regulations implementing the GLB Act, a financial holding company may engage in additional activities that are financial in nature or incidental or complementary to financial activity. Those activities include, among other activities, certain insurance and securities activities. We have not yet determined whether it would be appropriate or advisable in the future to become a financial holding company.

## **NBH Bank as a Colorado State-Chartered Bank**

On December 31, 2015, our bank subsidiary, NBH Bank, N.A., converted to a Colorado state-chartered bank operating under the name of NBH Bank. NBH Bank is also a member of the Federal Reserve Bank of Kansas City. As such, NBH Bank is subject to examination, supervision and regulation by both the Colorado Division of Banking and the Federal Reserve. NBH Bank's deposits are insured by the FDIC through the DIF, in the manner and to the extent provided by law. As an insured bank, NBH Bank is subject to the provisions of the Federal Deposit Insurance Act, as amended (the "FDI Act"), and the FDIC's implementing regulations thereunder, and may also be subject to supervision and examination by the FDIC under certain circumstances.

Under the FDIC Improvement Act of 1991 ("FDICIA"), NBH Bank must submit financial statements prepared in accordance with GAAP and management reports signed by the Company's and NBH Bank's chief executive officer and chief accounting or financial officer concerning management's responsibility for the financial statements, an assessment of internal controls, and an assessment of NBH Bank's compliance with various banking laws and FDIC and other banking regulations. In addition, we must submit annual audit reports to federal regulators prepared by independent auditors. As allowed by regulations, we may use our audit report prepared for the Company to satisfy this requirement. We must provide our auditors with examination reports, supervisory agreements and reports of enforcement actions. The auditors must also attest to and report on the statements of management relating to the internal controls. FDICIA also requires that NBH Bank form an independent audit committee consisting of outside directors only, or that the Company's audit committee be entirely independent.

## **Broad Supervision, Examination and Enforcement Powers**

The Federal Reserve, the FDIC and state bank regulators have broad regulatory, examination and enforcement authority over bank holding companies and banks, as applicable. Bank regulators regularly examine the operations of banks and bank holding companies. In addition, banks and bank holding companies are subject to periodic reporting and filing requirements.

Bank regulators have various remedies available if they determine that a banking organization has violated any law or regulation, that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of a banking organization's operations are unsatisfactory, or that the banking organization is operating in an unsafe or unsound manner. The bank regulators have the power to, among other things: enjoin "unsafe or unsound" practices, require affirmative actions to correct any violation or practice, issue administrative orders that can be judicially enforced, direct increases in capital, direct the sale of subsidiaries or other assets, limit dividends and distributions, restrict growth, assess civil monetary penalties, remove officers and directors, terminate deposit insurance, and appoint a conservator or receiver.

Engaging in unsafe or unsound practices or failing to comply with applicable laws, regulations and supervisory agreements could subject the Company, its subsidiaries and their respective officers, directors and institution-affiliated parties to the remedies described above and other sanctions. In addition, the FDIC could terminate NBH Bank's deposit insurance if it determined that the Bank's financial condition was unsafe or unsound or that the bank engaged in unsafe or unsound practices or violated an applicable rule, regulation, order or condition enacted or imposed by the bank's regulators.

## **Regulatory Capital Requirements**

### ***In General***

As a bank holding company, we are subject to regulatory capital adequacy requirements implemented by the Federal Reserve. The federal banking agencies have risk-based capital adequacy guidelines intended to provide a measure of capital adequacy that reflects the degree of risk associated with a banking organization's operations. NBH Bank also is, and other depository institution subsidiaries that we may acquire or control in the future will be, subject to capital adequacy guidelines as implemented by the relevant federal banking agency. In the case of the Company and NBH Bank, applicable capital guidelines can be found in the Federal Reserve's Regulations H and Q.

The capital rules require banks and bank holding companies to maintain a minimum common equity tier 1 capital ratio of 4.5%, a total tier 1 capital ratio of 6%, a total capital ratio of 8%, and a leverage ratio of 4%. Under recently revised

guidelines, bank holding companies will ultimately be required to hold a capital conservation buffer of common equity tier 1 capital of 2.5% to avoid limitations on capital distributions and executive compensation payments.

Further, the federal bank regulatory agencies may, however, set higher capital requirements for an individual bank or when a bank's particular circumstances warrant. At this time, the bank regulatory agencies are more inclined to impose higher capital requirements in order to be considered well-capitalized, and future regulatory change could impose higher capital standards as a routine matter.

The Federal Reserve may also set higher capital requirements for holding companies whose circumstances warrant it. For example, holding companies experiencing internal growth or making acquisitions are expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets.

### ***Prompt Corrective Action***

The FDI Act requires federal bank regulatory agencies to take "prompt corrective action" with respect to FDIC-insured depository institutions that do not meet minimum capital requirements. A depository institution's treatment for purposes of the prompt corrective action provisions will depend upon how its capital levels compare to various capital measures and certain other factors, as established by regulation. Federal banking regulators are required to take various mandatory supervisory actions and are authorized to take other discretionary actions with respect to institutions in the three undercapitalized categories. The severity of the action depends upon the capital category in which the institution is placed. Generally, subject to a narrow exception, the banking regulator must appoint a receiver or conservator for an institution that is critically undercapitalized. Our regulatory capital ratios and those of NBH Bank are in excess of the levels established for "well-capitalized" institutions.

### ***Bank Holding Companies as a Source of Strength***

The Federal Reserve requires that a bank holding company serve as a source of financial and managerial strength to each bank that it controls and, under appropriate circumstances, commit resources to support each such controlled bank. This support may be required at times when the bank holding company may not have the resources to provide the support. Because we are a bank holding company, the Federal Reserve views the Company (and its consolidated assets) as a source of financial and managerial strength for any controlled depository institutions.

Under the prompt corrective action provisions, if a controlled bank is undercapitalized, then the regulators could require its bank holding company to guarantee a capital restoration plan. In addition, if the Federal Reserve believes that a bank holding company's activities, assets or affiliates represent a significant risk to the financial safety, soundness or stability of a controlled bank, then the Federal Reserve could require the bank holding company to terminate the activities, liquidate the assets or divest the affiliates. The regulators may require these and other actions in support of controlled banks even if such action is not in the best interests of the bank holding company or its shareholders.

The Dodd-Frank Act codified the requirement that holding companies, like the Company, serve as a source of financial strength for their subsidiary depository institutions, by providing financial assistance to its insured depository institution subsidiaries in the event of financial distress. Under the source of strength doctrine, the Company could be required to provide financial assistance to NBH Bank should it experience financial distress.

In addition, capital loans by us to NBH Bank will be subordinate in right of payment to deposits and certain other indebtedness of NBH Bank. In the event of our bankruptcy, any commitment by us to a federal bank regulatory agency to maintain the capital of NBH Bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

## **Dividend Restrictions**

The Company is a legal entity separate and distinct from its subsidiaries. Because the Company's consolidated net income consists largely of the net income of NBH Bank, the Company's ability to pay dividends depends upon its receipt of dividends from its subsidiary. The ability of a bank to pay dividends and make other distributions is limited by federal and state law. The specific limits depend on a number of factors, including the bank's type of charter, recent earnings, recent dividends, level of capital and regulatory status. As a member of the Federal Reserve System and a Colorado state-chartered bank, NBH Bank is subject to Regulation H and limitations under Colorado law with respect to the payment of dividends. Non-bank subsidiaries are also limited by certain federal and state statutory provisions and regulations covering the amount of dividends that may be paid in any given year.

The ability of a bank holding company to pay dividends and make other distributions can also be limited. The Federal Reserve has authority to prohibit a bank holding company from paying dividends or making other distributions. A bank holding company should not pay cash dividends that exceed its net income or that can only be funded in ways that weaken the bank holding company's financial health, such as by borrowing. In addition, as a Delaware corporation, the Company is subject to certain limitations and restrictions under Delaware corporate law with respect to the payment of dividends and other distributions.

## **Depositor Preference**

The FDI Act provides that, in the event of the "liquidation or other resolution" of an insured depository institution, the claims of depositors of the institution (including the claims of the FDIC as subrogee of insured depositors) and certain claims for administrative expenses of the FDIC as a receiver will have priority over other general unsecured claims against the institution. If our insured depository institution fails, insured and uninsured depositors, along with the FDIC, will have priority in payment ahead of unsecured, nondeposit creditors, including us, with respect to any extensions of credit they have made to such insured depository institution.

## **Limits on Transactions with Affiliates**

Federal law restricts the amount and the terms of both credit and non-credit transactions (generally referred to as "Covered Transactions") between a bank and its non-bank affiliates. Covered Transactions with any single affiliate may not exceed 10% of the capital stock and surplus of the bank, and Covered Transactions with all affiliates may not exceed, in the aggregate, 20% of the bank's capital and surplus. For a bank, capital stock and surplus refers to the bank's tier 1 and tier 2 capital, as calculated under the risk-based capital guidelines, plus the balance of the allowance for credit losses excluded from tier 2 capital. The bank's transactions with all of its affiliates in the aggregate are limited to 20% of the foregoing capital. In addition, in connection with Covered Transactions that are extensions of credit, the bank may be required to hold collateral to provide added security to the bank, and the types of permissible collateral may be limited. The Dodd-Frank Act generally enhances the restrictions on transactions with affiliates, including an expansion of what types of transactions are Covered Transactions to include credit exposures related to derivatives, repurchase agreements and securities lending arrangements and an increase in the amount of time for which collateral requirements regarding Covered Transactions must be satisfied. As of December 31, 2017, the Company did not have any outstanding Covered Transactions.

## **Regulatory Notice and Approval Requirements for Acquisitions of Control**

We must generally receive federal bank regulatory approval before we can acquire an institution or business. Specifically, as a bank holding company, we must obtain prior approval of the Federal Reserve in connection with any acquisition that would result in the Company owning or controlling 5% or more of any class of voting securities of a bank or another bank holding company. Our ability to make investments in depository institutions will depend on our ability to obtain approval for such investments from the Federal Reserve. The Federal Reserve could deny our application based on the above criteria or other considerations. For example, we could be required to sell banking centers as a condition to receiving regulatory approval, which condition may not be acceptable to us or, if acceptable to us, may reduce the benefit of any acquisition.

Federal and state laws, including the BHCA and the Change in Bank Control Act, impose additional prior notice or approval requirements and ongoing regulatory requirements on any investor that seeks to acquire direct or indirect "control" of an

FDIC-insured depository institution or bank holding company. Whether an investor “controls” a depository institution is based on all of the facts and circumstances surrounding the investment. As a general matter, an investor is deemed to control a depository institution or other company if the investor owns or controls 25% or more of any class of voting securities. Subject to rebuttal, an investor is presumed to control a depository institution or other company if the investor owns or controls 10% or more of any class of voting securities and either the depository institution or company is a public company or no other person will hold a greater percentage of that class of voting securities after the acquisition. If an investor’s ownership of our voting securities were to exceed certain thresholds, the investor could be deemed to “control” us for regulatory purposes. This could subject the investor to regulatory filings or other regulatory consequences.

### **Anti-Money Laundering Requirements**

Under federal law, including the Bank Secrecy Act and the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the “USA PATRIOT Act”), certain types of financial institutions, including insured depository institutions, must maintain anti-money laundering programs that include established internal policies, procedures and controls; a designated compliance officer; an ongoing associate training program; and testing of the program by an independent audit function. Financial institutions are prohibited from entering into specified financial transactions and account relationships and must meet enhanced standards for due diligence, client identification, and recordkeeping, including in their dealings with non-U.S. financial institutions and non-U.S. clients. Financial institutions must take reasonable steps to conduct enhanced scrutiny of account relationships to guard against money laundering and to report any suspicious information maintained by financial institutions. Bank regulators routinely examine institutions for compliance with these obligations and they must consider an institution’s anti-money laundering compliance when considering regulatory applications filed by the institution, including applications for banking mergers and acquisitions. The regulatory authorities have imposed “cease and desist” orders and civil money penalty sanctions against institutions found to be violating these obligations.

### **Consumer Laws and Regulations**

Banks and other financial institutions are subject to numerous laws and regulations intended to protect consumers in their transactions with banks. These laws include, among others, laws regarding unfair and deceptive acts and practices and usury laws, as well as the following consumer protection statutes: Truth in Lending Act, Truth in Savings Act, Electronic Funds Transfer Act, Flood Disaster Protection Act, Expedited Funds Availability Act, Equal Credit Opportunity Act, Fair and Accurate Credit Transactions Act, Fair Housing Act, Fair Credit Reporting Act, Fair Debt Collection Act, GLB Act, Home Mortgage Disclosure Act, Right to Financial Privacy Act and Real Estate Settlement Procedures Act.

Many states and local jurisdictions have consumer protection laws analogous, and in addition, to those listed above. These state and local laws regulate the manner in which financial institutions deal with clients when taking deposits, making loans or conducting other types of transactions.

The Consumer Financial Protection Bureau (the “CFPB”) has broad rulemaking authority for a wide range of consumer financial laws that apply to all banks. The CFPB is authorized to issue rules for both bank and nonbank companies that offer consumer financial products and services, subject to consultation with the prudential banking regulators. In general, however, banks with assets of \$10 billion or less, such as NBH Bank, will continue to be examined for consumer compliance by their primary bank regulator.

Much of the CFPB’s rulemaking has focused on mortgage lending and servicing, including an important rule requiring lenders to ensure that prospective buyers have the ability to repay their mortgages. Other areas of current CFPB focus include consumer protections for prepaid cards, payday lending, debt collection, overdraft services and privacy notices. The CFPB has been particularly active in issuing rules and guidelines concerning residential mortgage lending and servicing, issuing numerous rules and guidance related to residential mortgages. Perhaps the most significant of these guidelines are the “Ability-to-Repay and Qualified Mortgage Standards under the Truth in Lending Act” portions of Regulation Z and the Know Before You Owe guidelines. Under the Dodd-Frank Act, creditors must make a reasonable and good faith determination, based on verified and documented information, that the consumer has a reasonable “ability to repay” a residential mortgage according to its terms as well as clearly and concisely disclose the terms and costs associated with these loans.

The CFPB has actively issued enforcement actions against both large and small entities and to entities across the entire financial services industry. The CFPB has relied upon “unfair, deceptive, or abusive acts” prohibitions as its primary enforcement tool. However, the CFPB and DOJ continue to be focused on fair lending in taking enforcement actions against banks with renewed emphasis on alleged redlining practices. Failure to comply with these laws and regulations could give rise to regulatory sanctions, client rescission rights, actions by state and local attorneys general and civil or criminal liability.

### **The Community Reinvestment Act**

The CRA is intended to encourage banks to help meet the credit needs of their entire communities, including low- and moderate-income neighborhoods, consistent with safe and sound operations. The regulators examine banks and assign each bank a public CRA rating. The CRA then requires bank regulators to take into account the bank’s record in meeting the needs of its community when considering certain applications by a bank, including applications to establish a banking center or to conduct certain mergers or acquisitions. The Federal Reserve is required to consider the CRA records of a bank holding company’s controlled banks when considering an application by the bank holding company to acquire a bank or to merge with another bank holding company.

When we apply for regulatory approval to make certain investments, the regulators will consider the CRA record of the target institution and our depository institution subsidiary. An unsatisfactory CRA record could substantially delay approval or result in denial of an application.

### **Reserve Requirements**

Pursuant to regulations of the Federal Reserve, all banks are required to maintain average daily reserves at mandated ratios against their transaction accounts. In addition, reserves must be maintained on certain non-personal time deposits. These reserves must be maintained in the form of vault cash or in an account at a Federal Reserve Bank.

### **Deposit Insurance Assessments**

All of a depositor’s accounts at an insured bank, including all non-interest bearing transaction accounts, are insured by the FDIC up to \$250,000. FDIC-insured banks are required to pay deposit insurance premiums to the FDIC. The FDIC has adopted a risk-based assessment system whereby FDIC-insured depository institutions pay insurance premiums at rates based on their risk classification. An institution’s risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to the regulators.

Assessments are based on an institution’s average total consolidated assets less average tangible equity (subject to risk-based adjustments that would further reduce the assessment base for custodial banks). NBH Bank may be able to pass part or all of this cost on to its clients, including in the form of lower interest rates on deposits, or fees to some depositors, depending on market conditions.

The FDIC may terminate a depository institution’s deposit insurance upon a finding that the institution’s financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the institution’s regulatory agency. If deposit insurance for a banking business we invest in or acquire were to be terminated, that would have a material adverse effect on that banking business and potentially on the Company as a whole.

### **Interstate Banking**

Under the Riegle-Neal Interstate Banking and Branching Efficiency Act (the “Riegle-Neal Act”), a bank holding company may acquire banks in states other than its home state, subject to any state requirement that the bank has been organized and operating for a minimum period of time, not to exceed five years, and the requirement that the bank holding company not control, prior to or following the proposed acquisition, more than 10% of the total amount of deposits of insured depository institutions nationwide or, unless the acquisition is the bank holding company’s initial entry into the state, more than 30% of such deposits in the state (or such lesser or greater amount set by the state). Bank holding companies must be well capitalized

and well managed, not merely adequately capitalized and adequately managed, in order to acquire a bank located outside of the bank holding company's home state.

The Riegle-Neal Act also authorizes banks to merge across state lines, thereby creating interstate banking centers. A national or state bank, with the approval of its regulator, may open a de novo banking center in any state if the law of the state in which the banking center is proposed would permit the establishment of the banking center if the bank were a bank chartered in that state.

The Federal Reserve, OCC, and FDIC jointly issued a final rule, effective October 10, 1977, that adopted uniform regulations implementing Section 109 of the Riegle-Neal Act. Section 109 prohibits any bank from establishing or acquiring a branch or branches outside of its home state primarily for the purpose of deposit production. Congress enacted Section 109 to ensure that interstate branches would not take deposits from a community without the bank reasonably helping to meet the credit needs of that community.

### **Changes in Laws, Regulations or Policies**

Congress and state legislatures may introduce from time to time measures or take actions that would modify the regulation of banks or bank holding companies. In addition, federal and state regulatory agencies also periodically propose and adopt changes to their regulations or change the manner in which existing regulations are applied. Such changes could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks and other financial institutions, all of which could affect our investment opportunities and our assessment of how attractive such opportunities may be. We cannot predict whether potential legislation will be enacted and, if enacted, the effect that it or any implementing regulations would have on our business, results of operations, liquidity or financial condition.

### **More Information**

Our website is [www.nationalbankholdings.com](http://www.nationalbankholdings.com). We make available free of charge, through our website, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the U.S. Securities and Exchange Commission ("SEC"). In addition, the public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at [www.sec.gov](http://www.sec.gov).

## **Item 1A. RISK FACTORS**

### **Risks Relating to Our Banking Operations**

*We are still a relatively young Company with a limited and complex operating history from which investors can evaluate our past financial and operating performance and future prospects.*

We were organized in 2009 and acquired selected assets and assumed selected liabilities of Hillcrest Bank, Bank Midwest, Bank of Choice and Community Banks of Colorado in October 2010, December 2010, July 2011 and October 2011, respectively, and acquired Pine River Valley Bank and Peoples, Inc. by merger in August 2015 and January 2018, respectively. Because our banking operations began in late 2010, and because our acquisitions in 2010 and 2011 were of failed or troubled banks, we have a limited operating history upon which investors can evaluate our operational performance or compare our recent performance to historical performance. The business models and experiences of the depository institutions we have acquired to date and may acquire in the future may not be reflective of our plans. More importantly, because a portion of our acquired loans and other real estate owned ("OREO") were covered by loss sharing agreements with the FDIC and all of the loans and OREO we acquired were marked to fair value at the time of our acquisitions, we believe that the historical financial results of the acquisitions are less useful to an evaluation of our future prospects and financial and operating performance.



Certain other factors may also make it difficult for investors to evaluate our future prospects and financial and operating performance, including, among others:

- our current asset mix, loan quality and allowance for loan losses are not fully representative of our anticipated future asset mix, loan quality and allowance for loan losses, which may change materially as we continue to undertake organic loan origination and banking activities and pursue future acquisitions;
- the income we report from certain acquired assets due to loan discounts and accretable yield may be higher than the returns available in the current market and, if we are unable to make new performing loans and acquire other performing assets in sufficient volume, we may be unable to generate the earnings necessary to implement our growth strategy;
- our excess cash reserves and liquid investment securities portfolio, may not be representative of our future cash position;
- our historical cost structure and capital expenditure requirements are not necessarily reflective of our anticipated cost structure and capital spending as we continue to identify efficiencies and operate our organic banking platform; and
- our regulatory capital ratios, which currently exceed regulatory minimum requirements, are not necessarily representative of our future regulatory capital ratios.

*Changes in general business and economic conditions could materially and adversely affect us.*

Our business and operations are sensitive to general business and economic conditions in the United States and in our two core markets in Colorado and the greater Kansas City region. If the economies in our core markets, or the U.S. economy more generally, experience worsening economic conditions, including industry-specific conditions, we could be materially and adversely affected. Weak economic conditions may be characterized by deflation, fluctuations in debt and equity capital markets, including a lack of liquidity and/or depressed prices in the secondary market for mortgage loans, increased delinquencies on loans, residential and commercial real estate price declines and lower home sales and commercial activity, and further or prolonged pressure on energy prices. All of these factors would be detrimental to our business. Our business is significantly affected by monetary and related policies of the U.S. federal government, its agencies and government-sponsored entities. Changes in any of these policies are influenced by macroeconomic conditions and other factors that are beyond our control and could have a material adverse effect on us.

*Changes in the assumptions underlying our acquisition method of accounting, or other significant accounting estimates could affect our financial information and have a material adverse effect on us.*

A material portion of our financial results is based on, and subject to, significant assumptions and subjective judgments. As a result of our acquisitions, our financial information is heavily influenced by the application of the acquisition method of accounting and was heavily influenced in prior periods by loss share accounting. Both methodologies require us to make complex assumptions, and these assumptions materially affect our financial results. As such, any financial information generated through the use of the acquisition method of accounting or loss share accounting is subject to modification or change. If our assumptions are incorrect and we change or modify our assumptions, it could have a material adverse effect on us or our previously reported results. Additionally, a change in our accounting estimates, such as our ability to realize deferred tax assets, the need for a valuation allowance or the recoverability of the goodwill recorded at the time of our acquisitions, could have a material adverse effect on our financial results.

*Our business is highly susceptible to credit risk and fluctuations in the value of real estate and other collateral securing such credit.*

As a lender, we are exposed to the risk that our clients will be unable to repay their loans according to their terms and that the collateral securing the payment of their loans (if any) may not be sufficient to assure repayment. The risks inherent in making any loan include risks with respect to the ability of borrowers to repay their loans and, if applicable, the period of time over which the loan is 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. Similarly, we have credit risk embedded in our securities portfolio. Our credit standards, procedures and policies may not prevent us from incurring substantial credit losses, particularly in light of market developments in recent years. A decline in residential real estate market prices and reduced levels of home sales, could adversely affect the value of collateral securing mortgage loans resulting in greater charge-offs in future periods, as well as adversely impact mortgage loan originations and gains on sale of mortgage loans. A decline in commercial real estate values would likewise adversely affect the value of collateral securing certain commercial loans and result in greater charge-offs in future periods. Declines in real estate values and home sales volumes, and financial stress on borrowers as a result of job losses or other factors, could have further adverse effects on borrowers that result in higher delinquencies and greater charge-offs in future periods, which could materially and adversely affect us.

*We depend on our executive officers and key personnel to implement our strategy and could be harmed by the loss of their services.*

The execution of our strategy depends in large part on the skills of our executive management team and our ability to motivate and retain these and other key personnel, including key personnel added through mergers and acquisitions. Accordingly, the loss of service of one or more of our executive officers or key personnel could reduce our ability to successfully implement our growth strategy and materially and adversely affect us. Our success also depends on the experience of our banking center managers and relationship managers and on their relationships with the clients and communities they serve. The loss of these key personnel could negatively impact our banking operations. The loss of key senior personnel, or the inability to recruit and retain qualified personnel in the future, could have a material adverse effect on us.

*Our allowance for loan losses and fair value adjustments may prove to be insufficient to absorb losses inherent in our loan or OREO portfolio.*

We maintain an allowance for loan losses (“ALL”), which is a reserve established through a provision for loan losses charged to expense, which we believe is appropriate to provide for probable losses inherent in our loan portfolio. The amount of this allowance is determined by our management through periodic reviews.

The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding our loans, identification of additional problem loans by us and other factors, both within and outside of our control, may require an increase in the allowance for loan losses. If the real estate markets deteriorate, we expect that we will experience increased delinquencies and credit losses, particularly with respect to construction, land development and land loans. In addition, our regulators periodically review our allowance for loan losses and may require an increase in the allowance for loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance for loan losses, we will need additional provisions to increase the allowance for loan losses. Any increases in the allowance for loan losses will result in a decrease in net income and capital and may have a material adverse effect on us.

*We hold and acquire an amount of OREO from time to time, which may lead to volatility in operating expenses and vulnerability to declines in real property values.*

When necessary, we foreclose on and take title to the real estate serving as collateral for our loans as part of our business. Real estate that we own but do not use in the ordinary course of our operations is referred to as OREO property. Higher

OREO balances as a result of our acquisitions have led to greater expenses as we incur costs to manage and dispose of the properties. We expect that our earnings will continue to be negatively affected by various expenses associated with OREO, including personnel costs, insurance and taxes, completion and repair costs, valuation adjustments and other expenses associated with property ownership, as well as by the funding costs associated with OREO assets. We evaluate OREO properties periodically and write down the carrying value of the properties if the results of our evaluation require it. The expenses associated with OREO and any further OREO write-downs could have a material adverse effect on us.

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

A significant portion of our loan portfolio is secured by real property, 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. There is a risk that hazardous or toxic substances could be found on these properties, and 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.

*The expanding body of federal, state and local regulation 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; 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 us.

*The fair value of our investment securities can fluctuate due to market conditions outside of our control.*

We have historically taken a conservative investment strategy with our securities portfolio, with concentrations of securities that are primarily backed by government sponsored enterprises. In the future, we may seek to increase yields through more aggressive strategies, which may include a greater percentage of corporate securities and structured credit products. Factors beyond our control can significantly influence the fair value of securities in our portfolio and can cause potential adverse changes to the fair value of these securities. These factors include, but are not limited to, rating agency actions in respect of the securities, defaults by the issuer or with respect to the underlying securities, and changes in market interest rates and instability in the capital markets. These factors, among others, could cause other-than-temporary impairments and realized and/or unrealized losses in future periods and declines in other comprehensive income, which could have a material adverse effect on us. The process for determining whether impairment of a security is other-than-temporary usually requires complex, subjective judgments about the future financial performance and liquidity of the issuer and any collateral underlying the security in order to assess the probability of receiving all contractual principal and interest payments on the security.

*We face significant competition from other financial institutions and financial services providers, which may materially and adversely affect us.*

Consumer and commercial banking is highly competitive. Our markets contain a large number of community and regional banks as well as a significant presence of the country's largest commercial banks. We compete with other state and national financial institutions, including savings and loan associations, savings banks and credit unions, for deposits and loans. In addition, we compete with financial intermediaries, such as consumer finance companies, mortgage banking companies, insurance companies, securities firms, mutual funds and several government agencies, as well as major retailers, in providing various types of loans and other financial services. Some of these competitors have a long history of successful operations in our markets, greater ties to local businesses and more expansive banking relationships, as well as better established depositor bases. Some of our competitors also have greater resources and access to capital and possess an advantage by being capable of maintaining numerous banking locations in more convenient sites, operating more ATMs and conducting extensive promotional and advertising campaigns or operating a more developed internet platform. Competitors may also exhibit a greater tolerance for risk and behave more aggressively with respect to pricing in order to increase their market share. In addition, the effects of disintermediation can also impact the banking business because of the fast growing body of FinTech companies that use software to deliver mortgage lending, payment services and other financial services.

Our ability to compete successfully depends on a number of factors, including, among others:

- the ability to develop, maintain and build upon long-term client relationships based on quality service, effective and efficient products and services, high ethical standards and safe and sound assets;
- the scope, relevance and pricing of products and services offered to meet client needs and demands;
- the rate at which we introduce new products and services relative to our competitors;
- the ability to attract and retain highly qualified associates to operate our business;
- the ability to expand our market position;
- client satisfaction with our level of service;
- the ability to invest in new technologies;
- the ability to operate our business effectively and efficiently; and
- industry and general economic trends.

Failure to perform in any of these areas could significantly weaken our competitive position, which could materially and adversely affect us.

*We may not be able to meet the cash flow requirements of deposit withdrawals and other business needs unless we maintain sufficient liquidity.*

We require liquidity to make loans and to repay deposit and other liabilities as they become due or are demanded by clients. We principally depend on checking, savings and money market deposit account balances and other forms of client deposits as our primary source of funding for our lending activities. As a result of a decline in overall depositor confidence, an increase in interest rates paid by competitors, general interest rate levels, higher returns being available to clients on alternative investments and general economic conditions, a substantial number of our clients could withdraw their bank deposits with us from time to time, resulting in our deposit levels decreasing substantially, and our cash on hand may not be able to cover such withdrawals and our other business needs, including amounts necessary to operate and grow our business. This would require us to seek third party funding or other sources of liquidity, such as asset sales. Our access to third party funding sources, including our ability to raise funds through the issuance of additional shares of our common stock or other equity or equity-related securities, incurrence of debt, and federal funds purchased, may be impacted by our financial strength, performance and prospects and may also be impaired by factors that are not specific to us, such as a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry, all of which may make potential funding sources more difficult to access, less reliable and more expensive. We may not have access to third party funding in sufficient amounts on favorable terms, or the ability to undertake asset sales or access other sources of liquidity, when needed, or at all, which could materially and adversely affect us.

*Like other financial services institutions, our asset and liability structures are monetary in nature. Such structures are affected by a variety of factors, including changes in interest rates, which can impact the value of financial instruments held by us.*

Like other financial services institutions, we have asset and liability structures that are essentially monetary in nature and are directly affected by many factors, including domestic and international economic and political conditions, broad trends in business and finance, legislation and regulation affecting the national and international business and financial communities, monetary and fiscal policies, inflation, currency values, market conditions, the availability and terms (including cost) of short-term or long-term funding and capital, the credit capacity or perceived creditworthiness of clients and counterparties and the level and volatility of trading markets. Such factors can impact clients and counterparties of a financial services institution and may impact the value of financial instruments held by a financial services institution.

Our earnings and cash flows largely depend upon the level of our net interest income, which is the difference between the interest income we earn on loans, investments and other interest earning assets, and the interest we pay on interest bearing liabilities, such as deposits and borrowings. Because different types of assets and liabilities may react differently and at different times to market interest rate changes, changes in interest rates can increase or decrease our net interest income. When interest-bearing liabilities mature or reprice more quickly than interest earning assets in a period, an increase in interest rates would reduce net interest income. Similarly, when interest earning assets mature or reprice more quickly, and because the magnitude of repricing of interest earning assets is often greater than interest bearing liabilities, falling interest rates would reduce net interest income.

Accordingly, changes in the level of market interest rates affect our net yield on interest earning assets and liabilities, loan and investment securities portfolios and our overall results. Changes in interest rates may also have a significant impact on any future loan origination revenues. Historically, there has been an inverse correlation between the demand for loans and interest rates. Loan origination volume and revenues usually decline during periods of rising or high interest rates and increase during periods of declining or low interest rates. Changes in interest rates also have a significant impact on the carrying value of a significant percentage of the assets, both loans and investment securities, on our balance sheet. We may incur debt in the future and that debt may also be sensitive to interest rates and any increase in interest rates could materially and adversely affect us. Interest rates are highly sensitive to many factors beyond our control, including general economic conditions and policies of various governmental and regulatory agencies, particularly the Federal Reserve. Changes in the Federal Reserve's interest rate policies or other changes in monetary policies and economic conditions could materially and adversely affect us.

*We are dependent on our information technology and telecommunications systems and third-party providers, and systems failures or interruptions could have a material adverse effect on us.*

Our business is highly dependent on the successful and uninterrupted functioning of our information technology and telecommunications systems and third-party providers. We outsource many of our major systems, such as data processing, loan servicing and deposit processing systems. The failure of these systems, or the termination of a third-party software license or service agreement on which any of these systems is based, could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. If significant, sustained or repeated, a system failure or service denial could compromise our ability to operate effectively, damage our reputation, result in a loss of client business, and/or subject us to additional regulatory scrutiny and possible financial liability, any of which could have a material adverse effect on us.

*A failure in or breach of our security systems or infrastructure, or those of our third-party providers, could result in financial losses to us or in the disclosure or misuse of confidential or proprietary information, including client information, and could have a material adverse effect on us.*

As a financial institution, we may be the target of fraudulent activity that may result in financial losses to us or our clients, privacy breaches against our clients or damage to our reputation. Such fraudulent activity may take many forms, including check fraud, electronic fraud, wire fraud, phishing, unauthorized intrusion into or use of our systems, ATM skimming or jackpotting, and other dishonest acts. We provide our clients with the ability to bank remotely, including via online, mobile

and phone. The secure transmission of confidential information over the internet and other remote channels is a critical element of remote banking.

Our network could be vulnerable to unauthorized access, computer viruses, phishing schemes, ransomware and other security breaches. We may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses. Given the increasingly high volume of our transactions, certain errors may be repeated or compounded before they can be discovered and rectified. To the extent that our activities or the activities of our clients involve the storage and transmission of confidential information, security breaches and viruses could expose us to reputational damage, claims, regulatory scrutiny, litigation and other possible liabilities. Any inability to prevent security breaches or computer viruses could also cause existing clients to lose confidence in our systems and could materially and adversely affect us. Our risk and exposure to these matters remains heightened because of the evolving nature and complexity of the threats from organized cybercriminals and hackers, and our plans to continue to provide digital banking products and services to our clients.

Information security risks for financial institutions like us have increased recently in part because of new technologies, the use of the internet and telecommunications technologies (including mobile devices) to conduct financial and other business transactions and the increased sophistication and activities of organized crime, perpetrators of fraud, hackers, terrorists and others. In addition to cyber-attacks or other security breaches involving the theft of sensitive and confidential information, hackers have engaged in attacks against large financial institutions, particularly denial of service attacks, that are designed to disrupt key business services, such as client-facing web sites. We are not able to anticipate or implement effective preventive measures against all security breaches of these types, especially because the techniques used change frequently and because attacks can originate from a wide variety of sources. We employ detection and response mechanisms designed to contain and mitigate security incidents, but early detection may be thwarted by sophisticated attacks and malware designed to avoid detection.

We also face risks related to cyber-attacks and other security breaches in connection with credit or debit card, including ATM-related, transactions that typically involve the transmission of sensitive information regarding our clients through various third parties, including merchant acquiring banks, payment processors, payment card networks (e.g., Visa, MasterCard) and our processors. Some of these parties have in the past been the target of security breaches and cyber-attacks, and because the transactions involve third parties and environments such as the point of sale that we do not control or secure, future security breaches or cyber-attacks affecting any of these third parties could impact us through no fault of our own, and in some cases we may have exposure and suffer losses for breaches or attacks relating to them. We also rely on numerous other third party service providers to conduct other aspects of our business operations and face similar risks relating to them. While we regularly conduct security assessments on these third parties, we cannot be sure that their information security protocols are sufficient to withstand a cyber-attack or other security breach.

### **Risks Relating to our Growth Strategy**

*We may not be able to effectively manage our growth.*

Our future operating results depend to a large extent on our ability to successfully manage our growth. Our growth has placed, and it may continue to place, significant demands on our operations and management. Whether through additional acquisitions or organic growth, our current plan to expand our business is dependent upon our ability to:

- continue to implement and improve our operational, credit, financial, legal, management and other internal risk controls and processes and our reporting systems and procedures in order to manage a growing number of client relationships;
- scale our technology platform;
- integrate our acquisitions and develop consistent policies throughout the various lines of businesses; and
- attract and retain management talent.

We may not successfully implement improvements to, or integrate, our management information and control systems, procedures and processes in an efficient or timely manner and may discover deficiencies in existing systems and controls. In particular, our controls and procedures must be able to accommodate an increase in loan volume in various markets and the

infrastructure that comes with new banking centers and banks. Thus, our growth strategy may divert management from our existing franchises and may require us to incur additional expenditures to expand our administrative and operational infrastructure and, if we are unable to effectively manage and grow our financial services franchise, we could be materially and adversely affected. In addition, if we are unable to manage future expansion in our operations, we may experience compliance and operational problems, have to slow the pace of growth, or have to incur additional expenditures beyond current projections to support such growth, any one of which could materially and adversely affect us.

*Our acquisitions generally will require regulatory approvals, and failure to obtain them would restrict our growth.*

We intend to complement and expand our business by pursuing strategic acquisitions of financial services franchises. Generally, any acquisition of target financial institutions, banking centers or other banking assets by us will require approval by, and cooperation from, a number of governmental regulatory agencies, including the Federal Reserve and Colorado Division of Banking. In acting on applications, our 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 Community Reinvestment Act (which we refer to as the “CRA”); and
- the effectiveness of the applicant in combating money laundering activities.

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 banking centers 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. In addition, prior to the submission of an application our regulators could discourage us from pursuing strategic acquisitions or indicate that regulatory approvals may not be granted on terms that would be acceptable to us, which could have the same effect of restricting our growth or reducing the benefit of any acquisitions.

*The success of future transactions will depend on our ability to successfully identify and consummate acquisitions of financial services franchises that meet our investment objectives. Because of the intense competition for acquisition opportunities and the limited number of potential targets, we may not be able to successfully consummate acquisitions on attractive terms.*

There are significant risks associated with our strategy to identify and successfully consummate acquisitions. There are a limited number of acquisition opportunities, and we expect to encounter intense competition from other banking organizations competing for acquisitions and also from other investment funds and entities looking to acquire financial institutions and financial services franchises. Many of these entities are well established and have extensive experience in identifying and consummating acquisitions directly or through affiliates. Many of these competitors possess ongoing banking operations with greater financial, technical, human and other resources and access to capital than we do, which could limit the acquisition opportunities we pursue. Our competitors may be able to achieve greater cost savings, through consolidating operations or otherwise, than we could. These competitive limitations give others an advantage in pursuing certain acquisitions. In addition, increased competition may drive up the prices for the acquisitions we pursue and make the other acquisition terms more onerous, which would make the identification and successful consummation of those acquisitions less attractive to us. Competitors may be willing to pay more for acquisitions than we believe are justified, which could result in us having to pay more for them than we prefer or to forego the opportunity. The trading price of our common stock and of the stock of other potential acquirers may affect our ability to offer a competitive price for acquisitions where stock is proposed as acquisition consideration. As a result of the foregoing, we may be unable to successfully identify and consummate acquisitions on attractive terms, or at all, that are necessary to grow our business.



*To the extent that we are unable to identify and consummate attractive acquisitions, or continue to increase loans through organic loan growth, we may be unable to successfully implement our growth strategy, which could materially and adversely affect us.*

We intend to continue to grow our business through strategic acquisitions of financial services franchises coupled with organic loan growth. Previous availability of attractive acquisition targets may not be indicative of future acquisition opportunities, and we may be unable to identify any acquisition targets that meet our investment objectives. As our acquired loan portfolio, which generally produces higher yields than our originated loans due to loan discounts and accretable yield, is paid down, we expect downward pressure on our income to the extent that the runoff is not replaced with other high-yielding loans. As a result of the foregoing, if we are unable to replace loans in our existing portfolio with comparable high-yielding loans, we could be materially and adversely affected. We could also be materially and adversely affected if we choose to pursue riskier higher-yielding loans that fail to perform.

*Projected operating results for businesses acquired by us may be inaccurate and may vary significantly from actual results. To the extent that we make acquisitions that involve distressed assets, we may not be able to realize the value we predict from these assets or make sufficient provision for future losses in the value of, or accurately estimate the future writedowns to be taken in respect of, these assets.*

We will generally establish the pricing of transactions and the capital structure of financial services franchises to be acquired by us on the basis of financial projections for such financial services franchises. In general, projected operating results will be based on the judgment of our management team. In all cases, projections are only estimates of future results that are based upon assumptions made at the time that the projections are developed and the projected results may vary significantly from actual results. General economic, political and market conditions can have a material adverse impact on the reliability of such projections. In the event that the projections made in connection with our acquisitions, or future projections with respect to new acquisitions, are not accurate, such inaccuracies could materially and adversely affect us.

Delinquencies and losses in the loan portfolios and other assets we acquire may exceed our initial forecasts developed during our due diligence investigation prior to their acquisition and, thus, produce lower returns than we believed our purchase price supported. Furthermore, our due diligence investigation may not reveal all material issues. If, during the diligence process, we fail to identify all relevant issues related to an acquisition, we may be forced to later write down or write off assets, restructure our operations, or incur impairment or other charges that could result in significant losses. Any of these events could materially and adversely affect us. Economic conditions may create an uncertain environment with respect to asset valuations and there is no certainty that we will be able to sell assets or institutions after we acquire them if we determine it would be in our best interests to do so. In addition, there may be limited liquidity for certain asset classes we hold, including commercial real estate and construction and development loans. Any of the foregoing matters could materially and adversely affect us.

*We face additional risks due to our increased mortgage banking activities that could negatively impact net income and profitability.*

We sell substantially all of the mortgage loans that we originate. The sale of these loans generates non-interest income and can be a source of liquidity for the Bank. Disruption in the secondary market for residential mortgage loans as well as declines in real estate values could result in one or more of the following:

- our inability to sell mortgage loans on the secondary market, which could negatively impact our liquidity position;
- declines in real estate values could decrease the potential of mortgage originations, which could negatively impact our earnings;
- if it is determined that loans were made in breach of our representations and warranties to the secondary market, we could incur losses associated with the loans;
- increased compliance requirements could result in higher compliance costs, higher foreclosure proceedings or lower loan origination volume, all which could negatively impact future earnings; and
- a rise in interest rates could cause a decline in mortgage originations, which could negatively impact our earnings.

*Our use of appraisals in deciding whether to make loans secured by real property does not ensure that the value of the real property collateral will be sufficient to repay our loans.*

In considering whether to make a loan secured by real property, we require an appraisal of the property. However, an appraisal is only an estimate of the value of the property at the time the appraisal is made and requires the exercise of a considerable degree of judgment. If the appraisal does not accurately reflect the amount that may be obtained upon sale or foreclosure of the property, whether due to a decline in property value after the date of the original appraisal or defective preparation of the appraisal, we may not realize an amount equal to the indebtedness secured by the property and as a result, we may suffer losses.

*Tax legislation initiatives or challenges to our tax positions could adversely affect our results of operations and financial condition.*

We operate in multiple jurisdictions and we are subject to tax laws and regulations of the U.S. federal, state and local governments. From time to time, legislative initiatives may be adopted, such as the recent tax reform in the United States, which may impact our effective tax rate and could adversely affect our deferred tax assets, tax positions and/or our tax liabilities. In addition, U.S. federal, state and local tax laws and regulations are extremely complex and subject to varying interpretations. There can be no assurance that our historical tax positions will not be challenged by relevant tax authorities or that we would be successful in defending our positions in connection with any such challenge.

Additionally, the full impact of “H.R.1”, known as the “Tax Cuts and Jobs Act” on us and our clients is unknown at present, creating uncertainty and risk related to our clients’ future demand for credit and our future results. Increased economic activity expected to result from the decrease in tax rates on business generally could spur economic activity that would encourage additional borrowing. At the same time, some clients may elect to use their additional cash flow from lower taxes to fund their existing levels of activity, decreasing borrowing needs. The elimination of the federal income tax deductibility of business interest expense for a number of our clients effectively increases the cost of borrowing and makes equity or hybrid funding relatively more attractive. This could have a long-term negative impact on business client borrowing. Further, uncertainty also exists surrounding the Tax Cuts and Jobs Act’s effects on housing markets, mortgage originations, unemployment rates, interest rates and the economies of the markets we serve. Finally, it is unclear how states and other taxing jurisdictions will respond to the Tax Cuts and Jobs Act.

## **Risks Relating to the Regulation of Our Industry**

*The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 continues to materially affect our business.*

The key effects of the Dodd-Frank Act on our business are:

- changes to regulatory capital requirements;
- creation of new government regulatory agencies (such as the Financial Stability Oversight Council, which oversees systemic risk, and the Consumer Financial Protection Bureau, which develops and enforces rules for bank and non-bank providers of consumer financial products);
- potential limitations on federal preemption;
- changes to deposit insurance assessments;
- regulation of debit interchange fees we earn;
- changes in retail banking regulations, including potential limitations on certain fees we may charge; and
- changes in regulation of consumer mortgage loan origination and risk retention.

Several provisions still require regulations to be promulgated by various federal agencies in order to be implemented, some of which have been proposed by the applicable federal agencies. The changes resulting from the Dodd-Frank Act have limited our business activities, required changes to certain of our business practices, imposed upon us more stringent capital, liquidity and leverage requirements or otherwise materially and may continue to adversely affect us. Failure to comply with the requirements could also materially and adversely affect us. Furthermore, additional uncertainties surrounding the Dodd-

Frank Act, its implementation, and enforcement persist as a result of the current presidential administration. Any changes in the laws or regulations or their interpretations could be materially adverse to investors in our common stock.

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

We are subject to extensive regulation, supervision, and legislation by federal and state regulators and bodies that govern almost all aspects of our operations. Intended to protect clients, depositors and the DIF, these laws and regulations, among other matters, prescribe minimum capital requirements, impose limitations on the business activities in which we can engage (including foreclosure and collection practices), limit the dividends or distributions that we can pay, restrict the ability of institutions to guarantee our debt, and impose certain specific accounting requirements on us that may be more restrictive and may result in greater or earlier charges to earnings or reductions in our capital than GAAP. Compliance with laws and regulations can be difficult and costly, and changes to laws and regulations often impose additional compliance costs. Our failure to comply with these laws and regulations, even if the failure follows good faith effort or reflects a difference in interpretation, could subject us to restrictions on our business activities, fines and other penalties, any of which could materially and adversely affect us. Further, any new laws, rules and regulations could make compliance more difficult or expensive and also materially and adversely affect us.

*The FDIC's restoration plan for the DIF and any related increased assessment rates could materially and adversely affect us.*

The FDIC insures deposits at FDIC-insured depository institutions, such as our subsidiary bank, up to applicable limits. The amount of a particular institution's deposit insurance assessment is based on that institution's risk classification under an FDIC risk-based assessment system. An institution's risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to its regulators. If current assessments imposed by the FDIC are insufficient for the DIF to meet its funding requirements, there may need to be further special assessments or increases in deposit insurance premiums. We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. Any future additional assessments, increases or required prepayments in FDIC insurance premiums may materially and adversely affect us, including by reducing our profitability or limiting our ability to pursue certain business opportunities.

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

Federal and state banking agencies periodically conduct examinations of our business, including compliance with laws and regulations. If, as a result of an examination, a federal or state banking agency were to determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of any of our operations had become unsatisfactory, or that we or our management was in violation of any law or regulation, it may take a number of different remedial actions as it deems appropriate. These actions include the power to enjoin "unsafe or unsound" practices, to require affirmative actions to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in our capital, to restrict our growth, to assess civil monetary penalties against our officers or directors, to remove officers and directors and, if it is concluded that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate our deposit insurance. If we become subject to such regulatory actions, we could be materially and adversely affected.

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

The CRA, the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations impose nondiscriminatory lending requirements on financial institutions. The Department of Justice and other federal agencies are responsible for enforcing these laws and regulations. A successful challenge to an institution's performance under the CRA or fair lending laws and regulations could result in a wide variety of sanctions, including damages and civil money penalties, injunctive relief, restrictions on mergers and acquisitions activity, and restrictions on expansion activity. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation.

*The Federal Reserve may require us to commit capital resources to support our subsidiary bank.*

As a matter of policy, the Federal Reserve, which examines us and our subsidiaries, expects a bank holding company to act as a source of financial and managerial strength to a subsidiary bank and to commit resources to support such subsidiary bank. Under the "source of strength" doctrine, the Federal Reserve may require a bank holding company to make capital injections into a troubled subsidiary bank and may charge the bank holding company with engaging in unsafe and unsound practices for failure to commit resources to such a subsidiary bank. In addition, the Dodd-Frank Act directs the federal bank regulators to require that all companies that directly or indirectly control an insured depository institution serve as a source of strength for the institution. Under this requirement, we could be required to provide financial assistance to our subsidiary bank should our subsidiary bank experience financial distress.

A capital injection may be required at times when we do not have the resources to provide it and therefore we may be required to borrow the funds or raise additional equity capital from third parties. Any loans by a holding company to its subsidiary bank are subordinate in right of payment to deposits and to certain other indebtedness of the subsidiary bank. In the event of a bank holding company's bankruptcy, the bankruptcy trustee will assume any commitment by the holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank. Moreover, bankruptcy law provides that claims based on any such commitment will be entitled to a priority of payment over the claims of the holding company's general unsecured creditors, including the holders of its indebtedness. Any financing that must be done by the holding company in order to make the required capital injection may be difficult and expensive and may not be available on attractive terms, or at all, which likely would have a material adverse effect on us.

*We face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.*

The federal Bank Secrecy Act, the USA PATRIOT Act and other laws and regulations require financial institutions, among other duties, to institute and maintain an effective anti-money laundering program and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network, established by the U.S. Treasury Department to administer the Bank Secrecy Act, is authorized to impose significant civil money penalties for violations of those requirements, and engages in coordinated enforcement efforts with the individual federal banking regulators, as well as the Department of Justice, Drug Enforcement Administration, and Internal Revenue Service. There is also increased scrutiny of compliance with the rules enforced by the Office of Foreign Assets Control. If our policies, procedures and systems are deemed deficient or the policies, procedures and systems of the financial institutions that we may acquire in the future are deficient, we would be subject to liability, including fines and regulatory actions (such as 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), which could materially and adversely affect us. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us.

*Federal, state and local consumer lending laws may restrict our ability to originate certain mortgage loans or increase our risk of liability with respect to such loans and could increase our cost of doing business.*

Federal, state and local laws have been adopted that are intended to eliminate certain lending practices considered "predatory." These laws prohibit practices such as steering borrowers away from more affordable products, selling unnecessary insurance to borrowers, repeatedly refinancing loans and making loans without a reasonable expectation that the borrowers will be able to repay the loans irrespective of the value of the underlying property. It is our policy not to make

predatory loans, but these laws create the potential for liability with respect to our lending and loan investment activities. They increase our cost of doing business and, ultimately, may prevent us from making certain loans and cause us to reduce the average percentage rate or the points and fees on loans that we do make.

*Our ability to pay dividends is subject to regulatory limitations and our bank subsidiary's ability to pay dividends to us is also subject to regulatory limitations.*

Our ability to declare and pay dividends depends both on the ability of our bank subsidiary to pay dividends to us and on certain federal regulatory considerations, including the guidelines of the Federal Reserve regarding capital adequacy and dividends. Because we are a separate legal entity from our bank subsidiary and we do not have significant operations of our own, any dividends paid by us to our shareholders would have to be paid from funds at the holding company level that are legally available therefor. However, as a bank holding company, we are subject to general regulatory restrictions on the payment of cash dividends. Federal bank regulatory agencies have the authority to prohibit bank holding companies from engaging in unsafe or unsound practices in conducting their business, which depending on the financial condition and liquidity of the holding company at the time, could include the payment of dividends. Additionally, various federal and state statutory provisions limit the amount of dividends that our bank subsidiary can pay to us as its holding company without regulatory approval. Finally, holders of our common stock are only entitled to receive such dividends as our board of directors may, in its unilateral discretion, declare out of funds legally available for such purpose based on a variety of considerations, including, without limitation, our historical and projected financial condition, liquidity and results of operations, capital levels, tax considerations, statutory and regulatory prohibitions and other limitations, general economic conditions and other factors deemed relevant by our board of directors. Accordingly, we may not pay the amount of dividends referenced in our current intention above, or any dividends at all, to our shareholders in the future.

**Item 1B. UNRESOLVED STAFF COMMENTS.**

None

**Item 2. PROPERTIES.**

Our principal executive offices are located in the Denver Tech Center area immediately south of Denver, Colorado. We also have approximately 70,000 square feet of office and operations space in Kansas City, Missouri. At December 31, 2017, we operated 44 banking centers in Colorado, 39 in Kansas and Missouri, and two in Texas. Of these banking centers, 13 locations were leased and 72 were owned.

**Item 3. LEGAL PROCEEDINGS.**

From time to time, we are a party to various litigation matters incidental to the conduct of our business. We are not presently party to any legal proceedings the resolution of which we believe would have a material adverse effect on our business, prospects, financial condition, results of operations or liquidity.

**Item 4. MINE SAFETY DISCLOSURES.**

None.

## PART II

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

#### Market for Registrant's Common Equity

Shares of the Company's common stock began trading on the New York Stock Exchange ("NYSE") under the symbol "NBHC" on September 20, 2012. Prior to September 20, 2012, there was no established public trading market for the Company's stock. The following table presents the high and low prices of actual transactions in the Company's common stock and cash dividends paid for the periods indicated:

Year	Quarter	High	Low	Cash dividends
2017	Fourth	\$ 37.08	\$ 30.33	\$ 0.09
	Third	\$ 36.04	\$ 30.25	\$ 0.09
	Second	\$ 33.85	\$ 30.10	\$ 0.09
	First	\$ 34.10	\$ 30.17	\$ 0.07
2016	Fourth	\$ 32.28	\$ 22.69	\$ 0.07
	Third	\$ 24.14	\$ 19.51	\$ 0.05
	Second	\$ 21.64	\$ 19.17	\$ 0.05
	First	\$ 21.40	\$ 18.41	\$ 0.05

The closing price of our common stock on the NYSE was \$33.42 per share on February 22, 2018. The Company had 217 shareholders of record as of February 22, 2018. Management estimates that the number of beneficial owners is significantly greater.

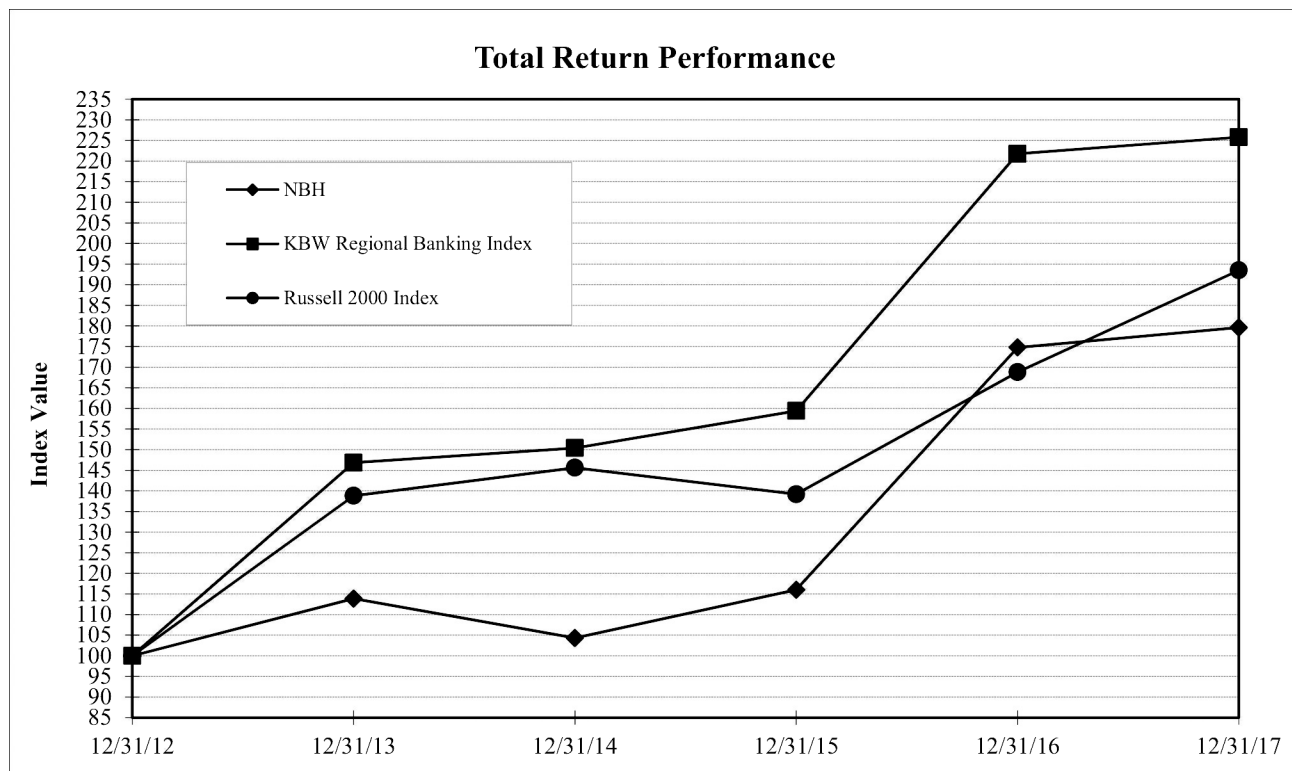
In October 2012, the Company commenced the payment of a \$0.05 per share quarterly cash dividend to holders of its common stock. During the fourth quarter of 2016, the Company increased its cash dividend 40% to \$0.07 per share, and during the second quarter of 2017 further increased its dividend 29% to \$0.09 per share, for a cumulative increase of 80%. As of December 31, 2017, the quarterly cash dividend is \$0.09 per share.

As a bank holding company, any dividends paid to us by our bank subsidiary are subject to various federal and state regulatory limitations and also subject to the ability of our bank subsidiary to pay dividends to us. Other than (1) dividends from the Bank paid as noted above, (2) the cash held by the Company and (3) any future financing at the holding company level, we do not expect to have other liquidity sources at the holding company level. In addition, in the future, we and our bank subsidiary may enter into credit agreements or other financing arrangements that prohibit or otherwise restrict our ability to declare or pay cash dividends. Any determination to pay cash dividends in the future will be at the discretion of our Board of Directors and will depend on a variety of considerations, including, without limitation, our historical and projected financial condition, liquidity and results of operations, capital levels, tax considerations, statutory and regulatory prohibitions and other limitations, general economic conditions and other factors deemed relevant by our Board of Directors. See "Risk Factors—Our ability to pay dividends is subject to regulatory limitations and our bank subsidiary's ability to pay dividends to us is also subject to regulatory limitations." During 2017, the Bank paid dividends of \$28.9 million to the holding company.

The Company may also execute permanent capital reductions at the Bank level in accordance with federal and state regulatory guidelines as a source of liquidity for the holding company. There were no permanent capital reduction during 2017.

## Performance Graph

The following graph presents a comparison of the Company's performance to the indices named below. It assumes \$100 invested on December 31, 2012, with dividends invested on a total return basis.



<i>Index</i>	<i>Period Ending</i>					
	<u>12/31/12</u>	<u>12/31/13</u>	<u>12/31/14</u>	<u>12/31/15</u>	<u>12/31/16</u>	<u>12/31/17</u>
NBH	100.00	113.86	104.31	116.00	174.77	179.62
KBW Regional Banking Index	100.00	146.83	150.39	159.41	221.77	225.78
Russell 2000 Index	100.00	138.82	145.62	139.19	168.81	193.50

The following table sets forth information about our repurchases of our common stock during the fourth quarter of 2017:

<u>Period</u>	<u>Total number of shares (or units) purchased</u>	<u>Average price paid per share (or unit)</u>	<u>Total number of shares (or units) purchased as part of publicly announced plans or programs</u>	<u>Maximum number (or approximate dollar value) of shares (or units) that may yet be purchased under the plans or programs <sup>(2)</sup></u>
October 1 - October 31, 2017 <sup>(1)</sup>	35,222	\$ 35.90	—	\$ 12,562,825
November 1 - November 30, 2017 <sup>(1)</sup>	518	33.28	—	12,562,825
December 1 - December 31, 2017 <sup>(1)</sup>	74	32.76	—	12,562,825
<b>Total</b>	<b>35,814</b>	<b>\$ 35.85</b>	<b>—</b>	<b>\$ 12,562,825</b>

- (1) These shares represent shares purchased other than through publicly announced plans and were purchased pursuant to the Company's stock incentive plans. Pursuant to the plans, shares were purchased from plan participants at the then current market value in satisfaction of stock option exercise prices, settlements of restricted stock and tax withholdings.
- (2) On August 5, 2016, the Company's Board of Directors authorized the repurchase of up to an additional \$50.0 million of common stock. Under this authorization, \$12,562,825 remained available for purchase at December 31, 2017.

### Securities Authorized for Issuance under Equity Compensation Plans

During the second quarter of 2014, shareholders approved the 2014 Omnibus Incentive Plan (the "2014 Plan"). Under the 2014 Plan, the Compensation Committee of the Board of Directors has the authority to grant, from time to time, awards of options, stock appreciation rights, restricted stock, restricted stock units, performance units, other stock-based awards, or any combination thereof to eligible persons. As of December 31, 2017, the aggregate number of Company common stock available for issuance under the 2014 Plan was 5,754,830 shares.

During the second quarter of 2015, shareholders approved the Company's 2014 Employee Stock Purchase Plan ("ESPP"). The ESPP allows employees to purchase shares of common stock through payroll deductions up to a limit of \$25,000 per calendar year or 2,000 shares per offering period. The price an employee pays for shares is 90.0% of the fair market value of Company common stock on the last day of the offering period. As of December 31, 2017, the aggregate number of Company common stock available for issuance under the ESPP was 355,159 shares.

See note 15 to the consolidated financial statements for further detail related to these equity compensation plans.

<u>Plan Category</u>	<u>Number of securities to be issued upon exercise of outstanding options, warrants and rights</u>	<u>Weighted-average exercise price of outstanding options, warrants and rights</u>	<u>Number of securities remaining available for future issuance under equity compensation plans</u>
Equity plans approved by security holders	1,598,318	\$ 20.62	6,109,989
Equity plans not approved by security holders	—	—	—
<b>Total</b>	<b>1,598,318</b>	<b>\$ 20.62</b>	<b>6,109,989</b>



**Item 6. SELECTED FINANCIAL DATA.**

The following table sets forth summary selected historical financial information as of and for the five years ended December 31, 2017. The summary selected historical consolidated financial information set forth below is derived from our audited consolidated financial statements.

The summary unaudited selected historical consolidated financial data set forth below should be read together with our consolidated financial statements and the related notes thereto and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included elsewhere in this annual report. Such information is not necessarily indicative of anticipated future results. All amounts are presented in thousands, except share data, or as otherwise noted.

**Summary of Selected Historical Consolidated Financial Data**

	<u>December 31, 2017</u>	<u>December 31, 2016</u>	<u>December 31, 2015</u>	<u>December 31, 2014</u>	<u>December 31, 2013</u>
<b>Consolidated Statement of Financial Condition</b>					
<b>Data:</b>					
Cash and cash equivalents	\$ 257,364	\$ 152,736	\$ 166,092	\$ 256,979	\$ 189,460
Investment securities available-for-sale (at fair value)	855,345	884,232	1,157,246	1,479,214	1,785,528
Investment securities held-to-maturity	258,730	332,505	427,503	530,590	641,907
Non-marketable securities	15,030	14,949	22,529	27,045	31,663
Loans <sup>(1)</sup>	3,178,947	2,860,921	2,587,673	2,162,409	1,854,094
Allowance for loan losses	<u>(31,264)</u>	<u>(29,174)</u>	<u>(27,119)</u>	<u>(17,613)</u>	<u>(12,521)</u>
Loans, net	3,147,683	2,831,747	2,560,554	2,144,796	1,841,573
Loans held for sale	4,629	24,187	13,292	5,146	5,787
FDIC indemnification asset, net	—	—	—	39,082	64,447
Other real estate owned	10,491	15,662	20,814	29,120	70,125
Premises and equipment, net	93,708	95,671	103,103	106,341	115,219
Goodwill and other intangible assets, net	61,237	66,579	72,059	76,513	81,859
Other assets	139,248	154,778	140,716	124,820	86,547
Total assets	<u>\$ 4,843,465</u>	<u>\$ 4,573,046</u>	<u>\$ 4,683,908</u>	<u>\$ 4,819,646</u>	<u>\$ 4,914,115</u>
Deposits	\$ 3,979,559	\$ 3,868,649	\$ 3,840,677	\$ 3,766,188	\$ 3,838,309
Other liabilities	331,499	168,208	225,687	258,883	178,014
Total liabilities	<u>4,311,058</u>	<u>4,036,857</u>	<u>4,066,364</u>	<u>4,025,071</u>	<u>4,016,323</u>
Total shareholders’ equity	<u>532,407</u>	<u>536,189</u>	<u>617,544</u>	<u>794,575</u>	<u>897,792</u>
Total liabilities and shareholders’ equity	<u>\$ 4,843,465</u>	<u>\$ 4,573,046</u>	<u>\$ 4,683,908</u>	<u>\$ 4,819,646</u>	<u>\$ 4,914,115</u>

(1) Total loans are net of unearned discounts and deferred fees and costs.

	As of and for the years ended				
	December 31, 2017	December 31, 2016	December 31, 2015	December 31, 2014	December 31, 2013
<b>Consolidated Statement of Operations</b>					
<b>Data:</b>					
Interest income	\$ 164,421	\$ 160,448	\$ 171,407	\$ 184,662	\$ 195,475
Interest expense	18,115	14,808	14,462	14,413	16,514
Net interest income	146,306	145,640	156,945	170,249	178,961
Provision for loan losses	12,972	23,651	12,444	6,209	4,296
Net interest income after provision for loan losses	133,334	121,989	144,501	164,040	174,665
Non-interest income	39,205	40,027	21,448	(1,696)	20,177
Non-interest expense	136,677	136,009	158,024	150,003	183,965
Income before income taxes	35,862	26,007	7,925	12,341	10,877
Income tax expense	21,283	2,947	3,044	3,165	3,950
Net income	<u>\$ 14,579</u>	<u>\$ 23,060</u>	<u>\$ 4,881</u>	<u>\$ 9,176</u>	<u>\$ 6,927</u>
<b>Share Information<sup>(1)</sup>:</b>					
Income per share, basic	\$ 0.54	\$ 0.81	\$ 0.14	\$ 0.22	\$ 0.14
Income per share, diluted	\$ 0.53	\$ 0.79	\$ 0.14	\$ 0.22	\$ 0.14
Dividends paid	\$ 0.34	\$ 0.22	\$ 0.20	\$ 0.20	\$ 0.20
Book value per share	\$ 19.81	\$ 20.32	\$ 20.34	\$ 20.43	\$ 19.99
Tangible common book value per share <sup>(2)</sup>	\$ 17.94	\$ 18.15	\$ 18.22	\$ 18.63	\$ 18.27
Tangible common equity to tangible assets <sup>(2)</sup>	10.06%	10.61%	11.98%	15.25%	16.97%
Weighted average common shares outstanding, basic	26,928,763	28,313,061	34,349,996	42,404,609	50,790,410
Weighted average common shares outstanding, diluted	27,709,659	29,091,343	34,363,487	42,421,014	50,824,422
Common shares outstanding	26,875,585	26,386,583	30,358,509	38,884,953	44,918,336

(1) Per share information is calculated based on the aggregate number of our shares of Class A common stock and Class B non-voting common stock outstanding.

(2) Tangible book value per share and tangible common equity to tangible assets are non-GAAP financial measures. Tangible book value per share is computed as total shareholders' equity less goodwill (adjusted for deferred taxes) and other intangible assets, net, divided by common shares outstanding at the balance sheet date. For purposes of computing tangible common equity to tangible assets, tangible common equity is calculated as common shareholders' equity less goodwill (adjusted for deferred taxes) and other intangible assets, net, and tangible assets is calculated as total assets less goodwill (adjusted for deferred taxes) and other intangible assets, net. We believe that the most directly comparable GAAP financial measures are book value per share and total shareholders' equity to total assets. See the reconciliation under "About Non-GAAP Financial Measures."

**As of and for the years ended**

	<b>December 31, 2017</b>	<b>December 31, 2016</b>	<b>December 31, 2015</b>	<b>December 31, 2014</b>	<b>December 31, 2013</b>
<b>Key Ratios</b>					
Return on average assets	0.31%	0.50%	0.10%	0.19%	0.13%
Return on average tangible assets <sup>(1)</sup>	0.38%	0.57%	0.17%	0.26%	0.20%
Return on average tangible assets before provision for loan losses and taxes FTE <sup>(1)(9)</sup>	1.29%	1.29%	0.60%	0.52%	0.40%
Return on average equity	2.67%	3.95%	0.70%	1.07%	0.67%
Return on average tangible common equity <sup>(1)</sup>	3.61%	5.04%	1.29%	1.58%	1.06%
Loans to deposits ratio (end of period)	80.00%	74.58%	67.72%	57.55%	48.46%
Average equity to average assets	11.62%	12.55%	14.52%	17.68%	20.07%
Non-interest bearing deposits to total deposits (end of period)	22.68%	21.89%	21.22%	19.45%	17.59%
Net interest margin <sup>(3)</sup>	3.36%	3.39%	3.54%	3.83%	3.81%
Net interest margin FTE <sup>(1)(3)(9)</sup>	3.50%	3.49%	3.60%	3.85%	3.81%
Interest rate spread FTE <sup>(4)(9)</sup>	3.35%	3.38%	3.48%	3.72%	3.68%
Yield on earning assets <sup>(2)</sup>	3.78%	3.74%	3.86%	4.15%	4.16%
Yield on earning assets FTE <sup>(1)(2)(9)</sup>	3.91%	3.84%	3.92%	4.17%	4.16%
Cost of interest bearing liabilities <sup>(2)</sup>	0.56%	0.46%	0.44%	0.45%	0.48%
Cost of deposits	0.41%	0.36%	0.36%	0.37%	0.41%
Non-interest expense to average assets	2.90%	2.92%	3.27%	3.08%	3.55%
Efficiency ratio FTE <sup>(1)(5)(9)</sup>	68.63%	68.79%	85.55%	85.82%	89.70%
Dividend Payout Ratio	62.96%	52.63%	142.86%	90.91%	142.86%
<b>Asset Quality Data<sup>(6)(7)(8)</sup></b>					
Non-performing loans to total loans	0.66%	1.07%	0.99%	0.50%	1.31%
Non-performing assets to total loans and OREO	0.99%	1.61%	1.81%	1.86%	4.97%
Allowance for loan losses to total loans	0.98%	1.02%	1.05%	0.81%	0.68%
Allowance for loan losses to non-performing loans	148.88%	94.98%	105.74%	162.89%	51.43%
Net charge-offs to average loans	0.36%	0.80%	0.12%	0.05%	0.41%
Non 310-30 net charge-offs to average non 310-30 loans	0.38%	0.85%	0.13%	0.06%	0.27%

- (1) Ratio represents non-GAAP financial measure. See non-GAAP reconciliation below.
- (2) Interest earning assets include assets that earn interest/accretion or dividends. Any market value adjustments on investment securities are excluded from interest-earning assets. Interest bearing liabilities include liabilities that must be paid interest.
- (3) Net interest margin represents net interest income, including accretion income on interest earning assets, as a percentage of average interest earning assets.
- (4) Interest rate spread represents the difference between the weighted average yield on interest earning assets and the weighted average cost of interest bearing liabilities.
- (5) The efficiency ratio represents non-interest expense, less intangible asset amortization, as a percentage of net interest income on a FTE basis plus non-interest income.
- (6) Non-performing loans were redefined during the third quarter of 2014 to only include non-accrual loans and restructured loans on non-accrual, and exclude any loans accounted for under ASC 310-30 in which the pool is still performing. All previous periods have been restated.
- (7) Non-performing assets include non-performing loans, other real estate owned and other repossessed assets.
- (8) Total loans are net of unearned discounts and fees.
- (9) Presented on a fully taxable equivalent basis using the statutory rate of 35%. The taxable equivalent adjustments included above are \$5,852, \$4,081, \$2,695, \$930 and \$0 for the years ended 2017, 2016, 2015, 2014 and 2013, respectively.

## **About Non-GAAP Financial Measures**

Certain of the financial measures and ratios we present, including “tangible assets,” “return on average tangible assets,” “return on average tangible assets before provision for loan losses and taxes,” “return on average tangible common equity,” “tangible common book value,” “tangible common book value per share,” “tangible common equity,” “tangible common equity to tangible assets,” “adjusted net income,” “adjusted income per share,” and “fully taxable equivalent (FTE)” metrics are supplemental measures that are not required by, or are not presented in accordance with, U.S. generally accepted accounting principles (GAAP). We refer to these financial measures and ratios as “non-GAAP financial measures.” We consider the use of select non-GAAP financial measures and ratios to be useful for financial and operational decision making and useful in evaluating period-to-period comparisons. We believe that these non-GAAP financial measures provide meaningful supplemental information regarding our performance by excluding certain expenditures or assets that we believe are not indicative of our primary business operating results or by presenting certain metrics on a FTE basis. We believe that management and investors benefit from referring to these non-GAAP financial measures in assessing our performance and when planning, forecasting, analyzing and comparing past, present and future periods.

These non-GAAP financial measures should not be considered a substitute for financial information presented in accordance with GAAP and you should not rely on non-GAAP financial measures alone as measures of our performance. The non-GAAP financial measures we present may differ from non-GAAP financial measures used by our peers or other companies. We compensate for these limitations by providing the equivalent GAAP measures whenever we present the non-GAAP financial measures and by including a reconciliation of the impact of the components adjusted for in the non-GAAP financial measure so that both measures and the individual components may be considered when analyzing our performance.

A reconciliation of our GAAP financial measures to the comparable non-GAAP financial measures is as follows.

### Tangible Common Book Value Ratios

	December 31, 2017	December 31, 2016	December 31, 2015	December 31, 2014	December 31, 2013
Total shareholders' equity	\$ 532,407	\$ 536,189	\$ 617,544	\$ 794,575	\$ 897,792
Less: goodwill and intangible assets, net	(61,237)	(66,580)	(72,060)	(76,513)	(81,859)
Add: deferred tax liability related to goodwill	10,873	9,323	7,772	6,222	4,671
Tangible common equity (non-GAAP)	<u>\$ 482,043</u>	<u>\$ 478,932</u>	<u>\$ 553,256</u>	<u>\$ 724,284</u>	<u>\$ 820,604</u>
Total assets	\$ 4,843,465	\$ 4,573,046	\$ 4,683,908	\$ 4,819,646	\$ 4,914,115
Less: goodwill and intangible assets, net	(61,237)	(66,580)	(72,060)	(76,513)	(81,859)
Add: deferred tax liability related to goodwill	10,873	9,323	7,772	6,222	4,671
Tangible assets (non-GAAP)	<u>\$ 4,793,101</u>	<u>\$ 4,515,789</u>	<u>\$ 4,619,620</u>	<u>\$ 4,749,355</u>	<u>\$ 4,836,927</u>

### Tangible common equity to tangible assets calculations:

Total shareholders' equity to total assets	10.99%	11.72%	13.18%	16.49%	18.27%
Less: impact of goodwill and intangible assets, net	(0.93)%	(1.11)%	(1.20)%	(1.24)%	(1.30)%
Tangible common equity to tangible assets (non-GAAP)	<u>10.06%</u>	<u>10.61%</u>	<u>11.98%</u>	<u>15.25%</u>	<u>16.97%</u>

### Tangible common book value per share calculations:

Tangible common equity (non-GAAP)	\$ 482,043	\$ 478,932	\$ 553,256	\$ 724,284	\$ 820,604
Divided by: ending shares outstanding	26,875,585	26,386,583	30,358,509	38,884,953	44,918,336
Tangible common book value per share (non-GAAP)	<u>\$ 17.94</u>	<u>\$ 18.15</u>	<u>\$ 18.22</u>	<u>\$ 18.63</u>	<u>\$ 18.27</u>

### Tangible common book value per share, excluding accumulated other comprehensive income (AOCI) calculations:

Tangible common equity (non-GAAP)	\$ 482,043	\$ 478,932	\$ 553,256	\$ 724,284	\$ 820,604
Less: AOCI, net of tax	6,242	1,762	(95)	(5,839)	6,756
Tangible common book value, excluding AOCI, net of tax (non-GAAP)	488,285	480,694	553,161	718,445	827,360
Divided by: ending shares outstanding	26,875,585	26,386,583	30,358,509	38,884,953	44,918,336
Tangible common book value per share, excluding AOCI, net of tax (non-GAAP)	<u>\$ 18.17</u>	<u>\$ 18.22</u>	<u>\$ 18.22</u>	<u>\$ 18.48</u>	<u>\$ 18.42</u>

## Return on Average Tangible Assets and Return on Average Tangible Equity

	As of and for the years ended				
	December 31, 2017	December 31, 2016	December 31, 2015	December 31, 2014	December 31, 2013
Net income	\$ 14,579	\$ 23,060	\$ 4,881	\$ 9,176	\$ 6,927
Add: impact of core deposit intangible amortization expense, after tax	3,259	3,343	3,295	3,260	3,235
Net income adjusted for impact of core deposit intangible amortization expense, after tax	<u>\$ 17,838</u>	<u>\$ 26,403</u>	<u>\$ 8,176</u>	<u>\$ 12,436</u>	<u>\$ 10,162</u>
Income before income taxes FTE (non-GAAP)	\$ 41,714	\$ 30,088	\$ 10,620	\$ 13,271	\$ 10,877
Add: impact of core deposit intangible amortization expense, before tax	5,342	5,480	5,401	5,344	5,346
Add: provision for loan losses	12,972	23,651	12,444	6,209	4,296
FTE income adjusted for impact of core deposit intangible amortization expense and provision (non-GAAP)	<u>\$ 60,028</u>	<u>\$ 59,219</u>	<u>\$ 28,465</u>	<u>\$ 24,824</u>	<u>\$ 20,519</u>
Average assets	\$ 4,705,241	\$ 4,651,953	\$ 4,831,070	\$ 4,867,929	\$ 5,175,210
Less: average goodwill and intangible assets, net of deferred tax liability related to goodwill	(52,958)	(59,977)	(66,549)	(73,074)	(79,964)
Average tangible assets (non-GAAP)	<u>\$ 4,652,283</u>	<u>\$ 4,591,976</u>	<u>\$ 4,764,521</u>	<u>\$ 4,794,855</u>	<u>\$ 5,095,246</u>
Average shareholders' equity	\$ 546,716	\$ 583,686	\$ 701,476	\$ 860,691	\$ 1,038,753
Less: average goodwill and intangible assets, net of deferred tax liability related to goodwill	(52,958)	(59,977)	(66,549)	(73,074)	(79,964)
Average tangible common equity (non-GAAP)	<u>\$ 493,758</u>	<u>\$ 523,709</u>	<u>\$ 634,927</u>	<u>\$ 787,617</u>	<u>\$ 958,789</u>
Return on average assets	0.31%	0.50%	0.10%	0.19%	0.13%
Return on average tangible assets (non-GAAP)	0.38%	0.57%	0.17%	0.26%	0.20%
Return on average tangible assets before provision for loan losses and taxes FTE (non-GAAP)	1.29%	1.29%	0.60%	0.52%	0.40%
Return on average equity	2.67%	3.95%	0.70%	1.07%	0.67%
Return on average tangible common equity (non-GAAP)	3.61%	5.04%	1.29%	1.58%	1.06%

## Fully Taxable Equivalent Yield on Earning Assets and Net Interest Margin

	As of and for the years ended				
	December 31, 2017	December 31, 2016	December 31, 2015	December 31, 2014	December 31, 2013
Interest income	\$ 164,421	\$ 160,448	\$ 171,407	\$ 184,662	\$ 195,475
Add: impact of taxable equivalent adjustment	5,852	4,081	2,695	930	—
Interest income FTE (non-GAAP)	<u>\$ 170,273</u>	<u>\$ 164,529</u>	<u>\$ 174,102</u>	<u>\$ 185,592</u>	<u>\$ 195,475</u>
Net interest income	\$ 146,306	\$ 145,640	\$ 156,945	\$ 170,249	\$ 178,961
Add: impact of taxable equivalent adjustment	5,852	4,081	2,695	930	—
Net interest income FTE (non-GAAP)	<u>\$ 152,158</u>	<u>\$ 149,721</u>	<u>\$ 159,640</u>	<u>\$ 171,179</u>	<u>\$ 178,961</u>
Average earning assets	\$ 4,353,320	\$ 4,290,171	\$ 4,439,139	\$ 4,446,903	\$ 4,698,552
Yield on earning assets	3.78%	3.75%	3.86%	4.15%	4.16%
Yield on earning assets FTE (non-GAAP)	3.91%	3.84%	3.92%	4.17%	4.16%
Net interest margin	3.36%	3.39%	3.54%	3.83%	3.81%
Net interest margin FTE (non-GAAP)	3.50%	3.49%	3.60%	3.85%	3.81%

## Adjusted Financial Results

	As of and for the year ended <u>December 31, 2017</u>
<b>Adjustments to net income:</b>	
Net income	\$ 14,579
Adjustments (non-GAAP) <sup>(1)</sup>	<u>20,430</u>
Adjusted net income (non-GAAP)	<u>\$ 35,009</u>
<b>Adjustments to income per share:</b>	
Income per share	\$ 0.53
Adjustments (non-GAAP) <sup>(1)</sup>	<u>0.73</u>
Adjusted income per share - diluted (non-GAAP) <sup>(1)</sup>	<u>\$ 1.26</u>
<b>Adjustments to return on average tangible assets:</b>	
Adjusted net income (non-GAAP) <sup>(1)</sup>	\$ 35,009
Add: impact of core deposit intangible amortization expense, after tax	<u>3,259</u>
Net income adjusted for impact of core deposit intangible amortization expense, after tax <sup>(1)</sup>	38,268
Average tangible assets (non-GAAP)	<u>4,652,283</u>
Adjusted return on average tangible assets (non-GAAP)	<u>0.82%</u>
<b>Adjustments to return on average tangible common equity:</b>	
Net income adjusted for impact of core deposit intangible amortization expense, after tax <sup>(1)</sup>	\$ 38,268
Average tangible common equity (non-GAAP)	<u>493,758</u>
Adjusted return on average tangible common equity (non-GAAP)	<u>7.75%</u>
<b>(1) Adjustments:</b>	
Non-interest expense adjustments:	
Acquisition-related	\$ 2,691
Special bonus accrual	<u>491</u>
Total pre-tax adjustments (non-GAAP)	3,182
Collective tax expense impact	(1,209)
Deferred tax asset re-measurement	<u>18,457</u>
Adjustments (non-GAAP)	<u>\$ 20,430</u>

## **Item 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

*The following management's discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes as of and for the years ended December 31, 2017, 2016, and 2015, and with the other financial and statistical data presented in this annual report. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions that may cause actual results to differ materially from management's expectations. Factors that could cause such differences are discussed in the section entitled “Cautionary Note Regarding Forward-Looking Statements” and “Risk Factors” and should be read herewith.*

*On December 31, 2015, our bank subsidiary converted to a Colorado state-chartered bank and changed its name from NBH Bank, N.A. to NBH Bank. All references to NBH Bank should be considered synonymous with references to NBH Bank, N.A. prior to the conversion and name change.*

*All amounts are in thousands, except share data, or as otherwise noted.*

### **Overview**

Our focus is on building strong banking relationships with small to medium-sized businesses and consumers, while maintaining a low risk profile designed to generate reliable income streams and attractive returns. We have established a solid financial services franchise with a sizable presence for deposit gathering and building client relationships necessary for growth. We believe that our established presence in core markets that are outperforming national averages positions us well for growth opportunities. As of December 31, 2017, we had \$4.8 billion in assets, \$3.2 billion in loans, \$4.0 billion in deposits and \$0.5 billion in equity.

### **Operating Highlights and Key Challenges**

#### *Increased profitability and returns*

- Net income was \$14.6 million, or \$0.53 per diluted share, for 2017 compared to net income of \$23.1 million, or \$0.79 per diluted share, for 2016. Net income during 2017 included a non-cash deferred tax asset re-measurement charge of \$18.5 million and \$3.2 million in one-time expenses primarily related to the acquisition of Peoples. Adjusting for these items, net income would have been \$35.0 million, or \$1.26 per diluted share.
- The return on average tangible assets was 0.38% for 2017 compared to 0.57% for 2016. Adjusting for the one-time expense items above, the return on average tangible assets was 0.82% for 2017.
- The return on average tangible common equity was 3.61% for 2017 compared to 5.04% for 2016. Adjusting for the one-time expense items above, the return on average tangible common equity was 7.75% for 2017.

#### *Strategic execution*

- Grew non 310-30 loan outstandings to \$3.1 billion, an increase of \$343.3 million, or 12.6%, since prior year.
- Maintained a conservatively structured loan portfolio represented by diverse industries and concentrations with most industry sector concentrations at 5% or less of total loans and all concentration levels remain well below our self-imposed limits.
- Continued to build and deepen relationships with our clients resulting in strong deposit growth, particularly average demand deposits which grew 7.8%, adjusting for banking center divestitures, since December 31, 2016.
- Maintained strong expense management, decreasing expenses \$76 million, or 36%, during the past five years, adjusted for \$3.2 million in one-time expenses primarily related to the acquisition of Peoples.
- Completed the acquisition of Peoples on January 1, 2018, which further strengthens the NBH franchise in the attractive and growing markets along the Colorado Front Range and the greater Kansas City region. The transaction is valued at \$146.4 million and adds an estimated \$868 million in assets, \$544 million in loans held for investment and \$730 million of low-cost deposits. The aggregate consideration of \$146.4 million consists of \$36.2 million in cash and the remainder in 3,398,477 share of NBHC common stock. The system conversion for this transaction was completed in the first quarter of 2018.



### *Loan portfolio*

- Total loans ended the year at \$3.2 billion and increased \$318.0 million, or 11.1%, since December 31, 2016, driven by new loan originations of \$879.2 million, led by commercial and industrial loan originations of \$515.4 million.
- Non 310-30 loans increased \$343.3 million, or 12.6%, led by commercial and industrial loans increasing 28.0% since December 31, 2016.
- Successfully exited \$25.2 million, or 17.3%, of the remaining acquired 310-30 loan portfolio, since December 31, 2016.
- Peoples adds complementary portfolio loans held for investment of an estimated \$544 million, represented by diverse industries with all pro-forma concentration levels well below our self-imposed limits.

### *Credit quality*

- Credit quality improved, as 90 days past due and non-accruing loans were 0.69% of total loans at December 31, 2017 compared to 1.13% at December 31, 2016. Non-performing assets to total loans and OREO totaled 0.99% at December 31, 2017 compared to 1.61% at December 31, 2016.
- Net charge-offs on non 310-30 loans totaled 0.38%, or 0.12% excluding the energy portfolio, compared to 0.85% in the prior year, or 0.10% excluding the energy portfolio.
- Provision for loan loss expense on non 310-30 loans totaled \$13.1 million compared to \$24.5 million in the prior year, a decrease of \$11.4 million driven entirely by a reduction in the provision for energy loans.

### *Client deposit funded balance sheet*

- Total deposits averaged \$4.0 billion during the fourth quarter of 2017, increasing \$273.5 million, or 7.3%, compared to the fourth quarter of 2016, adjusting for the banking center divestitures in the second quarter of 2017.
- Demand deposits averaged \$933.7 million during the fourth quarter of 2017 and grew \$111.8 million, or 13.6%, compared to the fourth quarter of 2016, adjusting for the banking center divestitures in the second quarter of 2017.
- Transaction deposits increased \$263.1 million, or 10.0%, for the fourth quarter of 2017 compared to the fourth quarter of 2016, adjusting for the banking center divestitures in the second quarter of 2017.
- Time deposits averaged \$1.1 billion during the fourth quarter of 2017, increasing \$10.4 million, compared to the fourth quarter of 2016, on an adjusted basis.
- The mix of transaction deposits to total deposits improved to 71.9% from 69.7% at December 31, 2016.
- Cost of deposits totaled 0.41%, increasing from 0.36% in the prior year, due to higher cost of savings, money market and time deposits.
- Peoples adds low cost deposits of an estimated \$730 million, with over 90% in transaction deposits. Pro-forma cost of deposits including Peoples would have been 0.37% during 2017.

### *Revenues*

- Fully taxable equivalent (FTE) net interest income totaled \$152.2 million and increased \$2.4 million, or 1.6%.
- The FTE net interest margin widened 0.01% to 3.50% from 2016 as the yield on earning assets increased 0.07%, led by a 0.27% increase in the originated portfolio yields, mostly offset by lower levels of income on high-yielding 310-30 loans and an increase in the cost of deposits of 0.05%.
- Non-interest income totaled \$39.2 million, decreasing \$0.8 million from prior year due to lower gain on sale of mortgages of \$0.7 million from lower volumes.

### *Expenses*

- Non-interest expense totaled \$136.7 million, representing an increase of \$0.7 million from prior year, due to \$3.2 million of one-time expenses primarily related to the Peoples acquisition.
- Income tax expense totaled \$21.3 million and included an \$18.5 million non-cash one-time charge primarily related to the deferred tax asset re-measurement, partially offset by \$4.2 million in tax benefits from stock compensation activity. Without these discrete items, tax expense would have been \$7.1 million, an effective tax rate of 19.7%.

### *Strong capital position*

- Capital ratios are strong as our capital position remains in excess of federal bank regulatory thresholds. As of December 31, 2017, our consolidated tier 1 leverage ratio was 9.8% and our consolidated tier 1 risk-based capital and common equity tier 1 risk-based capital ratios were both 12.9%.
- At December 31, 2017, common book value per share was \$19.81, while tangible common book value per share was \$17.94 and \$18.89 after consideration of the excess accretible yield value of \$0.95 per share. The deferred tax re-measurement charge impacted the tangible common book value per share by \$0.69.
- Since early 2013, we have repurchased 26.6 million shares, or 50.9% of then outstanding shares, at an attractive weighted average price of \$20.03 per share.

### *Key Challenges*

There are a number of significant challenges confronting us and our industry. In our short history, we primarily have acquired distressed financial institutions, and sought to rebuild them and implement operational efficiencies across the enterprise as a whole. We face continual challenges implementing our business strategy, including growing the assets and deposits of our business amidst intense competition, particularly for loans and deposits, low interest rates, changes in the regulatory environment and identifying and consummating disciplined merger and acquisition opportunities in a very competitive environment.

General economic conditions continued to improve in 2017. Residential real estate values have largely recovered from their lows and commercial real estate property fundamentals continued to improve in our markets and nationally across all property types and classes. A significant portion of our loan portfolio is secured by real estate and any deterioration in real estate values or credit quality or elevated levels of non-performing assets would ultimately have a negative impact on the quality of our loan portfolio.

Oil and gas prices began a steep decline in November 2014 and have remained historically low throughout 2017. While there have been job losses related to the energy sector, employment rates and job creation have trended favorably as other industry sectors have offset declines in energy. Nevertheless, the direct impact on the energy sector has been profound and we have experienced credit deterioration and credit losses in our energy loan portfolio. Energy loans comprised only 1.8% of our total loans; however, prolonged or further pricing pressure on oil and gas could lead to additional credit stress in our energy portfolio.

The agriculture industry is in the third year of depressed commodity prices. Our agriculture portfolio is only 4.4% of total loans and is well-diversified across crop and livestock types. We have maintained prudent client selectivity, leading to agriculture clients possessing low leverage and, correspondingly, low bank debt to assets, minimizing any potential credit losses in the future.

Our non 310-30 loans outstanding portfolio at December 31, 2017 totaled \$3.1 billion, representing an increase of \$343.3 million, or 12.6% compared to December 31, 2016, due to \$879.2 million in loan originations, partially offset by loan paydowns and payoffs during 2017. Our acquired loans have produced higher yields than our originated loans, due to accretion of fair value adjustments. During 2017, our weighted average rate on loan originations at the time of origination was 4.10% (fully taxable equivalent), compared to the weighted average yield of our total loan portfolio of 4.71% (fully taxable equivalent) and the weighted average rate on loan originations of 4.06% (fully taxable equivalent) for the year ended December 31, 2017. Downward pressure on the yields of our total loan portfolio will continue to the extent that our originated loan portfolio does not provide sufficient yields to replace the high yields on the acquired loan portfolio as they pay down or pay off. Fully taxable equivalent net interest income reached an inflection point in the second quarter of 2017 and continued during the fourth quarter of 2017 as the yields and volumes of originated loans outpaced the decrease in higher yielding acquired loan balances. The inflection point was driven by both the strong new loan originations as well as the short-term market rate increases in 2017. Future growth in our interest income will ultimately be dependent on our ability to continue to generate sufficient volumes of high-quality originated loans.

Continued regulation, impending new liquidity and capital constraints, and a continual need to bolster cybersecurity are adding costs and uncertainty to all U.S. banks and could affect profitability. Also, nontraditional participants in the market may offer increased competition as non-bank payment businesses are expanding into traditional banking products. While certain external factors are out of our control and may provide obstacles to our business strategy, we believe that we are prepared to deal with these challenges. We seek to remain flexible, yet methodical and proactive, in our strategic decision making so that we can quickly respond to market changes and the inherent challenges and opportunities that accompany such changes.

### **Application of Critical Accounting Policies**

We use accounting principles and methods that conform to GAAP and general banking practices. We are required to apply significant judgment and make material estimates in the preparation of our financial statements and with regard to various accounting, reporting and disclosure matters. Assumptions and estimates are required to apply these principles where actual measurement is not possible or practical. The most significant of these estimates relate to the accounting for acquired loans and the determination of the ALL. These critical accounting policies and estimates are summarized below, and are further analyzed with other significant accounting policies in note 2 – Summary of Significant Accounting Policies in the notes to our consolidated financial statements for the year ended December 31, 2017.

#### *Accounting for Acquired Loans*

Included in our loan portfolio are originated loans and acquired loans. The estimated fair values of acquired loans at the acquisition date are based on a discounted cash flow methodology that considers various factors, including the type of loan or pool of loans with similar characteristics, and related collateral, classification status, fixed or variable interest rate, maturity and any prepayment terms of the loan, whether or not the loan is amortizing, and a discount rate reflecting our assessment of risk inherent in the cash flow estimates. The determination of the fair value of acquired loans takes into account credit quality deterioration and probability of loss, and as a result the related allowance for loan losses is not carried forward at the time of acquisition.

A significant portion of the loans acquired in the Hillcrest Bank, Bank of Choice, and Community Banks of Colorado acquisitions had deteriorated credit quality at the date of acquisition and management accounted for all loans acquired through these acquisitions under ASC 310-30 (with the exception of loans with revolving privileges, which were outside the scope of ASC 310-30). These loans are grouped into pools based on purpose and/or type of loan, geography and risk rating, and take into account the sources of repayment and collateral. Each pool is accounted for as a single loan for which the integrity is maintained throughout the life of the asset. When a pool exhibits evidence of credit deterioration since origination and it is probable at the date of acquisition that we will not collect all principal and interest payments in accordance with the terms of the loan agreement, the expected shortfall in the expected future cash flows compared to the contractual amount due is recognized as a non-accretable difference. Any excess of the expected future cash flows over the acquisition date fair value is known as the accretable discount, or accretable yield, and through accretion is recognized as interest income over the remaining life of the respective pool. Contractual fees not expected to be collected are not included in ASC 310-30 contractual cash flows. Should fees be subsequently collected, the cash flows are accounted for as non 310-30 fee income in the period they are received. Loans that meet the criteria for non-accrual of interest at the time of acquisition may be considered performing at and subsequent to acquisition, regardless of whether the client is contractually delinquent, if the timing and expected cash flows on such loans can be reasonably estimated and if collection of the new carrying value of such loans is expected. If the timing and expected cash flows of a pool cannot be reasonably estimated, that pool may be placed on non-accrual status, the accretion of income will cease, and interest income will be recognized on a cash basis. In addition, a pool will be accounted for on a cash basis to the extent the remaining discount on the pool is equal its unpaid principal balance.

Loan pools accounted for under ASC 310-30 are periodically remeasured to determine expected future cash flows. In determining the expected cash flows, we evaluate the credit profile, contractual interest rates, collateral values and expected prepayments of the loan pools. Prepayment assumptions are based on statistical models that take into account factors such as the loan interest rate, credit profile of the borrowers, the years in which the loans were originated, and whether the loans were fixed or variable rate loans. Decreases to the expected future cash flows in the applicable pool generally result in an immediate provision for loan losses charged to the consolidated statements of operations. Conversely, subsequent increases in

the expected future cash flows result in a transfer from the non-accretable difference to the accretable yield, which is then accreted as a yield adjustment over the remaining life of the pool once any previously recorded impairment expense has been recouped. These cash flow estimations are inherently subjective as they require material estimates, all of which may be susceptible to significant change.

Loans outside the scope of ASC 310-30 are accounted for under ASC Topic 310, *Receivables*. Discounts created when the loans are recorded at their estimated fair values at acquisition are accreted over the remaining life of the loan as an adjustment to the respective loan's yield. Similar to originated loans, the accrual of interest income is discontinued on acquired loans that are not accounted for under ASC 310-30 when the collection of principal or interest, in whole or in part, is doubtful. Interest is not accrued on loans 90 days or more past due unless they are well secured and in the process of collection.

#### *Allowance for Loan Losses*

The determination of the ALL, which represents management's estimate of probable losses inherent in our loan portfolio at the balance sheet date, including acquired loans to the extent necessary, involves a high degree of judgment and complexity. The determination of the ALL takes into consideration, among other matters, the estimated fair value of the underlying collateral, economic conditions, particularly as such conditions relate to the market areas in which we operate, historical net loan losses and other factors that warrant recognition. Any change in these factors, or the rise of any other factors that we, or our regulators, may deem necessary to consider when estimating the ALL, may materially affect the ALL and provisions for loan losses. For further discussion of the ALL, see “—Financial Condition—Asset Quality” and “—Financial Condition—Allowance for Loan Losses” and notes 2 and 7 to our consolidated financial statements.

#### **Financial Condition**

Total assets increased to \$4.8 billion at December 31, 2017 from \$4.6 billion at December 31, 2016. Total loans were \$3.2 billion at December 31, 2017, and grew \$318.0 million, or 11.1% from December 31, 2016. Non 310-30 loan outstandings totaled \$3.1 billion and increased \$343.3 million, or 12.6%, from December 31, 2016. We originated \$879.2 million of loans during 2017, led by commercial and industrial originations of \$515.4 million. The acquired 310-30 loan portfolio declined \$25.2 million, or 17.3%, from December 31, 2016. Cash and cash equivalents totaled \$257.4 million and increased \$104.6 million, or 68.5%, from December 31, 2016 due to strong deposit balances. The investment securities portfolio decreased \$102.6 million, or 8.4%, to \$1.1 billion at December 31, 2017, due to paydowns within the portfolio. OREO decreased \$5.2 million or 33.0%, as we continue to resolve problem assets. During 2017, lower cost demand, savings, and money market ("transaction") deposits increased \$164.9 million, or 6.1%, excluding the four banking center divestitures during the second quarter of 2017, while time deposits decreased \$54.0 million, or 4.6%, as we continued to focus on developing long-term banking relationships with clients.

#### *Investment Securities*

##### Available-for-sale

Total investment securities available-for-sale were \$855.3 million at December 31, 2017, compared to \$884.2 million at December 31, 2016, a decrease of \$28.9 million, or 3.3%. During 2017 and 2016, maturities and pay downs of available-for-sale securities totaled \$224.3 million and \$275.5 million, respectively. Purchases of available-for-sale securities during 2017 and 2016 totaled \$202.7 million and \$4.9 million, respectively.

Our available-for-sale investment securities portfolio is summarized as follows for the periods indicated:

	December 31, 2017				December 31, 2016			
	Amortized cost	Fair value	Percent of portfolio	Weighted average yield	Amortized cost	Fair value	Percent of portfolio	Weighted average yield
Mortgage-backed securities (“MBS”):								
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	\$ 167,269	\$ 168,648	19.8%	2.39%	\$ 223,781	\$ 227,160	25.8%	2.31%
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	702,107	685,230	80.1%	1.93%	666,616	652,739	73.8%	1.71%
Municipal securities	1,054	1,048	0.1%	2.60%	3,921	3,914	0.4%	3.34%
Other securities	419	419	0.0%	0.00%	419	419	0.0%	0.00%
Total investment securities available-for-sale	<u>\$ 870,849</u>	<u>\$ 855,345</u>	<u>100.0%</u>	<u>2.02%</u>	<u>\$ 894,737</u>	<u>\$ 884,232</u>	<u>100.0%</u>	<u>1.86%</u>

As of December 31, 2017 and 2016, generally the entire available-for-sale investment portfolio was backed by mortgages. The residential mortgage pass-through securities portfolio is comprised of both fixed rate and adjustable rate Federal Home Loan Mortgage Corporation (“FHLMC”), Federal National Mortgage Association (“FNMA”) and Government National Mortgage Association (“GNMA”) securities. The other mortgage-backed securities are comprised of securities backed by FHLMC, FNMA and GNMA securities.

At December 31, 2017 and 2016, adjustable rate securities comprised 4.9% and 6.7%, respectively, of the available-for-sale MBS portfolio. The remainder of the portfolio was comprised of fixed rate amortizing securities with 10 to 30 year contractual maturities, with a weighted average coupon of 2.18% per annum and 1.97% per annum at December 31, 2017 and 2016, respectively.

The available-for-sale investment portfolio included \$18.2 million and \$16.5 million of gross unrealized losses at December 31, 2017 and 2016, respectively, which were partially offset by \$2.7 million and \$6.0 million of gross unrealized gains, respectively. We believe any unrecognized losses are a result of prevailing interest rates, and as such, we do not believe that any of the securities with unrealized losses were other-than-temporarily-impaired.

#### Held-to-maturity

At December 31, 2017, we held \$258.7 million of held-to-maturity investment securities, compared to \$332.5 million at December 31, 2016, a decrease of \$73.8 million, or 22.2%. The Company did not purchase any held-to-maturity securities during 2017 or 2016.

Held-to-maturity investment securities are summarized as follows as of the date indicated:

	December 31, 2017				December 31, 2016			
	Amortized cost	Fair value	Percent of portfolio	Weighted average yield	Amortized cost	Fair value	Percent of portfolio	Weighted average yield
Mortgage-backed securities (“MBS”):								
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	\$ 204,352	\$ 204,048	79.0%	3.23%	\$ 263,411	\$ 264,862	79.2%	3.24%
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	54,378	52,723	21.0%	1.66%	69,094	67,711	20.8%	1.68%
Total investment securities held-to-maturity	<u>\$ 258,730</u>	<u>\$ 256,771</u>	<u>100.0%</u>	<u>2.90%</u>	<u>\$ 332,505</u>	<u>\$ 332,573</u>	<u>100.0%</u>	<u>2.91%</u>

The residential mortgage pass-through and other residential MBS held-to-maturity investment portfolios are comprised of fixed rate FHLMC, FNMA and GNMA securities.

The fair value of the held-to-maturity investment portfolio was \$256.8 million and \$332.6 million, at December 31, 2017 and 2016, respectively, and included \$2.0 million of net unrealized losses and \$0.1 million of net unrealized gains for the respective periods.

### Loans Overview

At December 31, 2017, our loan portfolio was comprised of new loans that we have originated and loans that were acquired in connection with our five acquisitions to date. As discussed in note 2 to our consolidated financial statements, in accordance with applicable accounting guidance, all acquired loans are recorded at fair value at the date of acquisition, and an allowance for loan losses is not carried over with the loans but, rather, the fair value of the loans encompasses both credit quality and contractual interest rate considerations. Loans that exhibit signs of credit deterioration at the date of acquisition are accounted for in accordance with the provisions of ASC 310-30. Management accounted for all loans acquired in the Hillcrest Bank, Bank of Choice and Community Banks of Colorado acquisitions under ASC 310-30, with the exception of loans with revolving privileges, which were outside the scope of ASC 310-30. In our Bank Midwest transaction, we did not acquire all of the loans of the former Bank Midwest but, rather, selected certain loans based upon specific criteria of performance, adequacy of collateral, and loan type that were performing at the time of acquisition. As a result, none of the loans acquired in the Bank Midwest transaction are accounted for under ASC 310-30. None of the loans acquired in the Pine River transaction are accounted for under ASC 310-30.

The table below shows the loan portfolio composition and the breakout of the portfolio between ASC 310-30 loans and non 310-30 loans at the respective dates:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>	<u>2017 vs 2016 % Change</u>
Loans excluded from ASC 310-30:			
Commercial:			
Commercial and industrial	\$ 1,376,022	\$ 1,074,696	28.0%
Owner occupied commercial real estate	272,753	221,544	23.1%
Agriculture	138,895	134,637	3.2%
Energy	57,460	90,273	(36.3)%
Total commercial	<u>1,845,130</u>	<u>1,521,150</u>	21.3%
Commercial real estate non-owner occupied	485,141	437,642	10.9%
Residential real estate	703,478	728,361	(3.4)%
Consumer	<u>24,575</u>	<u>27,916</u>	(12.0)%
Total loans excluded from ASC 310-30	3,058,324	2,715,069	12.6%
Loans accounted for under ASC 310-30:			
Commercial	29,475	39,280	(25.0)%
Commercial real estate non-owner occupied	77,908	89,150	(12.6)%
Residential real estate	12,759	16,524	(22.8)%
Consumer	<u>481</u>	<u>898</u>	(46.4)%
Total loans accounted for under ASC 310-30	<u>120,623</u>	<u>145,852</u>	(17.3)%
Total loans	<u>\$ 3,178,947</u>	<u>\$ 2,860,921</u>	11.1%

Our loan portfolio totaled \$3.2 billion at December 31, 2017, increasing 318.0 million, or 11.1%, year-over-year on the strength of \$879.2 million in loan originations between the two periods. The strong originations were the result of continued market penetration. Non 310-30 loan outstandings totaled \$3.1 billion representing an increase of \$343.3 million, or 12.6%, year-over-year, led by a 21.3% increase in total commercial loans. The acquired 310-30 loan portfolio declined \$25.2 million, or 17.3%, from December 31, 2016.

We have successfully generated new relationships with small to medium-sized businesses and consumers, experiencing particularly strong loan growth in our commercial and industrial portfolio, which at December 31, 2017, was comprised of diverse industry segments. These segments included public administration-related loans of \$396.3 million, finance and insurance-related loans of \$263.9 million, health care related loans of \$143.3 million, manufacturing-related loans of \$88.2 million, and a variety of smaller subcategories of commercial and industrial loans.

Non-owner occupied CRE loans were 111.0% of the Company's risk based capital, or 17.5% of total loans, and no specific property type comprised more than 5.0% of total loans. The Company maintains very little exposure to retail properties, comprising just 2.3% of total loans. Multi-family loans totaled \$26.9 million, or less than 1.0% of total loans as of December 31, 2017. Agriculture loans were 29.5% of the Company's risk based capital and 4.4% of total loans, and are well-diversified across crop and livestock types.

The table below shows the geographic breakout of our loan portfolio at December 31, 2017 and 2016, based on the domicile of the borrower or, in the case of collateral-dependent loans, the geographical location of the collateral:

	December 31, 2017		December 31, 2016	
	Loan balance	Percent of loan portfolio	Loan balance	Percent of loan portfolio
Colorado	\$ 1,343,144	42.3%	\$ 1,188,155	41.5%
Missouri	577,887	18.2%	595,964	20.8%
Texas	331,003	10.4%	296,539	10.4%
Kansas	247,969	7.8%	245,059	8.6%
New York	90,730	2.8%	—	0.0%
California	89,560	2.8%	90,643	3.2%
Other	498,654	15.7%	444,561	15.5%
Total	<u>\$ 3,178,947</u>	<u>100.0%</u>	<u>\$ 2,860,921</u>	<u>100.0%</u>

New loan origination is a direct result of our ability to recruit and retain top banking talent, connect with clients in our markets and provide needed services at competitive rates. Loan originations totaled \$879.2 million over the past twelve months, led by commercial and industrial loan originations of \$515.4 million. Originations are defined as closed end funded loans and revolving lines of credit advances, net of any current period paydowns. Management utilizes this more conservative definition of originations to better approximate the impact of originations on loans outstanding and ultimately net interest income. The following tables represent new loan originations during 2017 and 2016:

	Fourth quarter 2017	Third quarter 2017	Second quarter 2017	First quarter 2017	Total 2017
Commercial:					
Commercial and industrial	\$ 167,699	\$ 73,917	\$ 159,340	\$ 114,414	\$ 515,370
Owner occupied commercial real estate	8,937	32,787	6,899	16,988	65,611
Agriculture	14,050	3,335	16,696	(3,644)	30,437
Energy	(8,121)	(6,993)	9,120	(81)	(6,075)
Total commercial	<u>182,565</u>	<u>103,046</u>	<u>192,055</u>	<u>127,677</u>	<u>605,343</u>
Commercial real estate non-owner occupied	21,323	46,654	47,312	36,962	152,251
Residential real estate	25,995	28,471	26,979	29,616	111,061
Consumer	1,815	3,122	3,233	2,378	10,548
Total	<u>\$ 231,698</u>	<u>\$ 181,293</u>	<u>\$ 269,579</u>	<u>\$ 196,633</u>	<u>\$ 879,203</u>

Included in originations are net fundings under revolving lines of credit of \$65,686, \$(12,804), \$68,305 and \$33,397 as of the fourth quarter 2017, third quarter 2017, second quarter 2017 and first quarter 2017, respectively.

	Fourth quarter 2016	Third quarter 2016	Second quarter 2016	First quarter 2016	Total 2016
Commercial:					
Commercial and industrial	\$ 109,670	\$ 92,433	\$ 142,179	\$ 59,361	\$ 403,643
Owner occupied commercial real estate	18,606	19,091	17,883	10,399	65,979
Agriculture	18,480	9,589	18,072	10,375	56,516
Energy	4,433	(1,251)	(17,328)	(13,984)	(28,130)
Total Commercial	151,189	119,862	160,806	66,151	498,008
Commercial real estate non-owner occupied	30,227	54,456	89,109	44,876	218,668
Residential real estate	89,968	102,703	63,815	49,722	306,208
Consumer	3,566	4,995	3,158	2,671	14,390
Total	<u>\$ 274,950</u>	<u>\$ 282,016</u>	<u>\$ 316,888</u>	<u>\$ 163,420</u>	<u>\$ 1,037,274</u>

Included in originations are net fundings under revolving lines of credit of \$18,670, \$26,959, \$85,345 and \$9,565 as of the fourth quarter 2016, third quarter 2016, second quarter 2016 and first quarter 2016, respectively. Residential real estate loan originations decreased \$195.1 million during 2017 when compared to 2016, due to the Company no longer including loans held for sale in its definition of originated.

The tables below show the contractual maturities of our loans for the dates indicated:

	December 31, 2017			
	Due within	Due after 1 but	Due after	Total
	1 year	within 5 years	5 years	
Commercial:				
Commercial and industrial	\$ 83,314	\$ 551,567	\$ 745,746	\$ 1,380,627
Owner occupied commercial real estate	18,044	115,421	156,306	289,771
Agriculture	14,513	102,390	29,845	146,748
Energy	25,970	31,489	—	57,459
Total commercial	141,841	800,867	931,897	1,874,605
Commercial real estate non-owner occupied	118,980	316,242	127,827	563,049
Residential real estate	6,820	38,824	670,593	716,237
Consumer	5,909	15,014	4,133	25,056
Total loans	<u>\$ 273,550</u>	<u>\$ 1,170,947</u>	<u>\$ 1,734,450</u>	<u>\$ 3,178,947</u>

	December 31, 2016			
	Due within	Due after 1 but	Due after	Total
	1 year	within 5 years	5 years	
Commercial:				
Commercial and industrial	\$ 68,485	\$ 455,444	\$ 559,421	\$ 1,083,350
Owner occupied commercial real estate	18,887	92,739	131,434	243,060
Agriculture	22,146	92,269	29,332	143,747
Energy	18,840	71,433	—	90,273
Total commercial	128,358	711,885	720,187	1,560,430
Commercial real estate non-owner occupied	126,784	279,135	120,873	526,792
Residential real estate	9,554	35,506	699,825	744,885
Consumer	5,529	18,164	5,121	28,814
Total loans	<u>\$ 270,225</u>	<u>\$ 1,044,690</u>	<u>\$ 1,546,006</u>	<u>\$ 2,860,921</u>



The stated interest rate (which excludes the effects of non-refundable loan origination and commitment fees, net of costs and the accretion of fair value marks) of non 310-30 loans with maturities over one year is as follows at the dates indicated:

	December 31, 2017					
	Fixed		Variable		Total	
	Balance	Weighted average rate	Balance	Weighted average rate	Balance	Weighted average rate
Commercial						
Commercial and industrial <sup>(1)</sup>	\$ 696,224	3.34%	\$ 597,253	4.14%	\$ 1,293,477	3.71%
Owner occupied commercial real estate	125,821	4.20%	133,408	4.26%	259,229	4.39%
Agriculture	35,605	4.70%	89,487	4.42%	125,092	4.50%
Energy	132	4.37%	31,357	4.57%	31,489	4.57%
Total commercial	857,782	3.57%	851,505	4.20%	1,709,287	3.89%
Commercial real estate non-owner occupied	161,846	4.42%	237,772	4.46%	399,618	4.44%
Residential real estate	372,104	3.40%	325,227	3.94%	697,331	3.65%
Consumer	15,883	4.68%	2,805	4.59%	18,688	4.67%
Total loans with > 1 year maturity	<u>\$ 1,407,615</u>	3.64%	<u>\$ 1,417,309</u>	4.19%	<u>\$ 2,824,924</u>	3.91%

	December 31, 2016					
	Fixed		Variable		Total	
	Balance	Weighted average rate	Balance	Weighted average rate	Balance	Weighted average rate
Commercial						
Commercial and industrial <sup>(1)</sup>	\$ 544,464	3.25%	\$ 464,713	3.80%	\$ 1,009,177	3.50%
Owner occupied commercial real estate	114,513	4.13%	92,535	4.32%	207,048	4.41%
Agriculture	41,373	4.62%	72,140	3.68%	113,513	4.02%
Energy	7,174	0.93%	64,259	3.60%	71,433	3.05%
Total commercial	707,524	3.46%	693,647	3.84%	1,401,171	3.65%
Commercial real estate non-owner occupied	136,965	4.51%	221,527	3.65%	358,492	3.98%
Residential real estate	402,616	3.37%	316,784	3.73%	719,400	3.53%
Consumer	19,127	4.49%	3,395	4.06%	22,522	4.42%
Total loans with > 1 year maturity	<u>\$ 1,266,232</u>	3.56%	<u>\$ 1,235,353</u>	3.78%	<u>\$ 2,501,585</u>	3.67%

- (1) Included in commercial fixed rate loans are loans totaling \$417,660 and \$313,000 as of December 31, 2017 and 2016, respectively, that have been swapped to variable rates at current market pricing. Included in the commercial segment are tax exempt loans totaling \$617,889 and \$384,641 with a weighted average rate of 3.15% and 3.01% at December 31, 2017 and 2016, respectively.

#### Accretable Yield

At December 31, 2017, the accretable yield balance was \$46.6 million compared to \$60.5 million at December 31, 2016. We re-measure the expected cash flows quarterly for all 25 remaining loan pools accounted for under ASC 310-30 utilizing the same cash flow methodology used at the time of acquisition. This re-measurement resulted in a net \$8.6 million and \$9.5 million reclassification from non-accretable difference to accretable yield during 2017 and 2016, respectively.

In addition to the accretable yield on loans accounted for under ASC 310-30, the fair value adjustments on loans outside the scope of ASC 310-30 are also accreted to interest income over the life of the loans. Total remaining accretable yield and fair value mark was as follows for the dates indicated:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
Remaining accretable yield on loans accounted for under ASC 310-30	\$ 46,568	\$ 60,476
Remaining accretable fair value mark on loans not accounted for under ASC 310-30	1,771	3,236
Total remaining accretable yield and fair value mark	<u>\$ 48,339</u>	<u>\$ 63,712</u>

### *Asset Quality*

All of the assets acquired in our acquisitions were marked to fair value at the date of acquisition, and the fair value adjustments to loans included a credit quality component. We utilize traditional credit quality metrics to evaluate the overall credit quality of our loan portfolio; however, our credit quality ratios are somewhat limited in their comparability to industry averages or to other financial institutions because of the percentage of acquired problem loans and given that any asset quality deterioration that existed at the date of acquisition was considered in the original fair value adjustments.

Asset quality is fundamental to our success and remains a strong point, driven by our disciplined adherence to our self-imposed concentration limits across industry sector and real estate property type. Accordingly, for the origination of loans, we have established a credit policy that allows for responsive, yet controlled lending with credit approval requirements that are scaled to loan size. Within the scope of the credit policy, each prospective loan is reviewed in order to determine the appropriateness and the adequacy of the loan characteristics and the security or collateral prior to making a loan. We have established underwriting standards and loan origination procedures that require appropriate documentation, including financial data and credit reports. For loans secured by real property, we require property appraisals, title insurance or a title opinion, hazard insurance and flood insurance, in each case where appropriate.

Additionally, we have implemented procedures to timely identify loans that may become problematic in order to ensure the most beneficial resolution to the Company. Asset quality is monitored by our credit risk management department and evaluated based on quantitative and subjective factors such as the timeliness of contractual payments received. Additional factors that are considered, particularly with commercial loans over \$500,000, include the financial condition and liquidity of individual borrowers and guarantors, if any, and the value of our collateral. To facilitate the oversight of asset quality, loans are categorized based on the number of days past due and on an internal risk rating system, and both are discussed in more detail below.

Our internal risk rating system uses a series of grades which reflect our assessment of the credit quality of loans based on an analysis of the borrower's financial condition, liquidity and ability to meet contractual debt service requirements. Loans that are perceived to have acceptable risk are categorized as "Pass" loans. "Special mention" loans represent loans that have potential credit weaknesses that deserve close attention. Special mention loans include borrowers that have potential weaknesses or unwarranted risks that, unless corrected, may threaten the borrower's ability to meet debt service requirements. However, these borrowers are still believed to have the ability to respond to and resolve the financial issues that threaten their financial situation. Loans classified as "Substandard" have a well-defined credit weakness and are inadequately protected by the current paying capacity of the obligor or of the collateral pledged, if any. Although these loans are identified as potential problem loans, they may never become non-performing. Substandard loans have a distinct possibility of loss if the deficiencies are not corrected. "Doubtful" loans are loans that management believes that collection of payments in accordance with the terms of the loan agreement are highly questionable and improbable. Doubtful loans are deemed impaired and put on non-accrual status.

Non 310-30 special mention loans increased \$12.5 million from December 31, 2016 due to upgrades from substandard and doubtful within the commercial and industrial sector and downgrades from pass within the commercial and industrial sector, partially offset by payoffs in the commercial and industrial and owner-occupied commercial real estate sectors. Non 310-30 substandard loans decreased \$23.3 million from December 31, 2016 primarily due to paydowns and upgrades to special mention and pass within the commercial and industrial, owner-occupied commercial real estate and energy sectors. Non 310-30 doubtful loans decreased \$3.9 million from December 31, 2016 due to energy loan charge-offs during the period. At December 31, 2017 there is one substandard commercial real estate non-owner occupied loan with an unpaid principal

balance of \$24.9 million within a pool accounted for under ASC 310-30 that is being actively worked out and may transfer to OREO in 2018.

In the event of borrower default, we may seek recovery in compliance with state lending laws, the respective loan agreements, and credit monitoring and remediation procedures that may include modifying or restructuring a loan from its original terms, for economic or legal reasons, to provide a concession to the borrower from their original terms due to borrower financial difficulties in order to facilitate repayment. Such restructured loans are considered "troubled debt restructurings" or "TDRs" in accordance with ASC 310-40, *Troubled Debt Restructurings by Creditors*. Under this guidance, modifications to loans that fall within the scope of ASC 310-30 are not considered troubled debt restructurings, regardless of otherwise meeting the definition of a troubled debt restructuring. Assets that have been foreclosed on or acquired through deed-in-lieu of foreclosure are classified as OREO until sold, and are carried at the lower of the related loan balance or the fair value of the collateral less estimated costs to sell, with any initial valuation adjustments charged to the ALL and any subsequent declines in carrying value charged to impairments on OREO.

#### *Non-performing Assets*

Non-performing assets consist of non-accrual loans, troubled debt restructurings on non-accrual, OREO and other repossessed assets. Non-accrual loans and troubled debt restructurings on non-accrual accounted for under ASC 310-30, as described below, may be excluded from our non-performing assets to the extent that the cash flows of the loan pools are still estimable. During the third quarter of 2014, we revised our definition of non-performing assets and non-performing loans to exclude accruing loans 90 days past due and accruing troubled debt restructurings to more accurately align the financial metrics related to non-performing assets and non-performing loans with our financial results. Prior period information has been modified for this revision. Interest income that would have been recorded had non-accrual loans performed in accordance with their original contract terms during 2017, 2016 and 2015 was \$1.5 million, \$2.6 million and \$1.4 million, respectively.

All loans accounted for under ASC 310-30 were classified as performing assets at December 31, 2017, as the future cash flows on the loan pools were considered estimable. While individual loans making up the pools may be accounted for on a cost recovery basis, the cash flows on the loan pools are considered estimable and, therefore, interest income, through accretion of the difference between the carrying value of the loans in the pool and the pool's expected future cash flows, is being recognized on all acquired loan pools accounted for under ASC 310-30.

The following table sets forth the non-performing assets as of the dates presented:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>	<u>December 31, 2015</u>	<u>December 31, 2014</u>	<u>December 31, 2013</u>
Non-accrual loans:					
Commercial:					
Commercial and industrial	\$ 3,747	\$ 1,160	\$ 942	\$ 221	\$ 15,572
Owner occupied commercial					
real estate	3,336	2,054	954	385	467
Agriculture	2,003	297	1,904	130	153
Energy	—	6,517	—	—	—
Total commercial	<u>9,086</u>	<u>10,028</u>	<u>3,800</u>	<u>736</u>	<u>16,192</u>
Commercial real estate non-					
owner occupied	784	66	407	222	1,131
Residential real estate	3,846	3,875	3,617	2,845	3,437
Consumer	29	40	30	37	10
Total non-accrual loans, excluding restructured loans	<u>13,745</u>	<u>14,009</u>	<u>7,854</u>	<u>3,840</u>	<u>20,770</u>
Restructured loans on non-accrual:					
Commercial:					
Commercial and industrial	4,020	7,527	3,888	3,994	535
Owner occupied commercial					
real estate	143	2	319	458	225
Agriculture	—	1,608	81	365	—
Energy	1,645	6,128	12,009	—	—
Total commercial	<u>5,808</u>	<u>15,265</u>	<u>16,297</u>	<u>4,817</u>	<u>760</u>
Commercial real estate non-					
owner occupied	—	—	815	—	169
Residential real estate	1,336	1,301	679	1,966	2,408
Consumer	111	142	2	190	237
Total restructured loans on non-accrual	<u>7,255</u>	<u>16,708</u>	<u>17,793</u>	<u>6,973</u>	<u>3,574</u>
Total non-performing loans	<u>21,000</u>	<u>30,717</u>	<u>25,647</u>	<u>10,813</u>	<u>24,344</u>
OREO	10,491	15,662	20,814	29,120	70,125
Other repossessed assets	—	—	894	849	1,086
Total non-performing assets	<u>\$ 31,491</u>	<u>\$ 46,379</u>	<u>\$ 47,355</u>	<u>\$ 40,782</u>	<u>\$ 95,555</u>
Loans 90 days or more past due and still accruing interest	\$ 150	\$ —	\$ 166	\$ 263	\$ 129
Accruing restructured loans	\$ 8,461	\$ 5,766	\$ 8,403	\$ 19,275	\$ 11,605
ALL	\$ 31,264	\$ 29,174	\$ 27,119	\$ 17,613	\$ 12,521
Total non-performing loans to total loans	0.66%	1.07%	0.99%	0.50%	1.31%
Loans 90 days or more past due and still accruing interest to total loans	0.00%	0.00%	0.01%	0.01%	0.01%
Total non-performing assets to total loans and OREO	0.99%	1.61%	1.81%	1.86%	4.97%
ALL to non-performing loans	148.88%	94.98%	105.74%	162.89%	51.43%

During 2017, total non-performing loans decreased \$9.7 million, or 31.6%, from December 31, 2016 due to charge-offs of two energy loans totaling \$7.5 million and one commercial and industrial loan totaling \$2.5 million. In addition, one previously identified energy loan of \$2.2 million at December 31, 2017 was placed back on accrual during the third quarter of 2017. These decreases were offset by one commercial and industrial loan totaling \$3.7 million placed on non-accrual during the fourth quarter of 2017. During 2017, accruing TDRs increased \$2.7 million primarily due to increases in the commercial

segment totaling \$3.3 million, partially offset by decreases of \$0.5 million in the residential real estate segment. During 2017, \$1.8 million of loans were foreclosed or otherwise repossessed and transferred to OREO and \$10.4 million of OREO was sold resulting in a net gain of \$4.2 million. OREO write-downs of \$0.8 million were recorded during 2017.

Total non-performing assets to total loans and OREO was 0.99% and 1.61% at December 31, 2017 and 2016, respectively. Included in this ratio at December 31, 2017 are acquired non-performing loans and OREO of 0.46% compared to 0.71% at December 31, 2016. Acquired OREO has been a source of income for the Company as net OREO gains totaled \$4.2 million and \$4.4 million for the years ended December 31, 2017 and 2016, respectively. In addition, the ratio includes 0.05% and 0.44% of non-performing energy loans at December 31, 2017 and 2016, respectively. The remaining non-performing assets to total loans and OREO was 0.48% at December 31, 2017 and 0.46% and December 31, 2016.

The following table represents the carrying value of our accruing and non-accrual loans compared to the unpaid principal balance ("UPB") as of December 31, 2017:

	Accruing			Non-accrual			Total		
	Unpaid principal balance	Carrying value	Carrying value/ UPB	Unpaid principal balance	Carrying value	Carrying value/ UPB	Unpaid principal balance	Carrying value	Carrying value/ UPB
Non ASC 310-30 loans									
Commercial:									
Commercial and industrial	\$ 1,368,740	\$ 1,368,255	99.9%	\$ 11,678	\$ 7,767	66.5%	\$ 1,380,418	\$ 1,376,022	99.7%
Owner occupied commercial real estate	270,039	269,275	99.7%	3,745	3,478	92.9%	273,784	272,753	99.6%
Agriculture	137,353	136,892	99.7%	2,041	2,003	98.1%	139,394	138,895	99.6%
Energy	56,267	55,815	99.2%	6,269	1,645	26.2%	62,536	57,460	91.9%
Total commercial	1,832,399	1,830,237	99.9%	23,733	14,893	62.8%	1,856,132	1,845,130	99.4%
Commercial real estate non-owner occupied	486,154	484,357	99.6%	830	784	94.5%	486,984	485,141	99.6%
Residential real estate	699,305	698,295	99.9%	6,031	5,183	85.9%	705,336	703,478	99.7%
Consumer	24,435	24,435	100.0%	145	140	96.6%	24,580	24,575	99.9%
Total non ASC 310-30 loans	3,042,293	3,037,324	99.8%	30,739	21,000	68.3%	3,073,032	3,058,324	99.5%
ASC 310-30 loans									
Commercial	42,468	29,475	69.4%	—	—	0.0%	42,468	29,475	69.4%
Commercial real estate non-owner occupied	83,753	77,908	93.0%	—	—	0.0%	83,753	77,908	93.0%
Residential real estate	18,728	12,759	68.1%	—	—	0.0%	18,728	12,759	68.1%
Consumer	3,575	481	13.5%	—	—	0.0%	3,575	481	13.5%
Total loans accounted for under ASC 310-30	148,524	120,623	81.2%	—	—	0.0%	148,524	120,623	81.2%
Total loans	\$ 3,190,817	\$ 3,157,947	99.0%	\$ 30,739	\$ 21,000	68.3%	\$ 3,221,556	\$ 3,178,947	98.7%

### Past Due Loans

Past due status is monitored as an indicator of credit deterioration. Loans are considered past due or delinquent when the contractual principal or interest due in accordance with the terms of the loan agreement remains unpaid after the due date of the scheduled payment. Loans that are 90 days or more past due and not accounted for under ASC 310-30 are put on non-accrual status unless the loan is well secured and in the process of collection. The table below shows the past due status of loans not accounted for under ASC 310-30, based on contractual terms of the loans as of December 31, 2017 and 2016:

	December 31, 2017	December 31, 2016
Loans 30-89 days past due and still accruing interest	\$ 3,681	\$ 2,296
Loans 90 days past due and still accruing interest	150	—
Non-accrual loans	21,000	30,717
Total past due and non-accrual loans	\$ 24,831	\$ 33,013
Total 90 days past due and still accruing interest and non-accrual loans to total non 310-30 loans	0.69%	1.13%
Total non-accrual loans to total non 310-30 loans	0.69%	1.13%
% of total past due and non-accrual loans that carry fair value marks	14.66%	10.75%

Loans 30-89 days past due and still accruing interest increased \$1.4 million from December 31, 2016 to December 31, 2017 and loans 90 days or more past due and still accruing interest increased \$0.2 million from December 31, 2016 to December 31, 2017, for a collective increase in total past due loans of \$1.6 million. Non-accrual loans decreased \$9.7 million at December 31, 2017 compared to December 31, 2016, further described within the Non-Performing Assets discussion of Management's Discussion and Analysis. There were no ASC 310-30 loan pools past due or on non-accrual at December 31, 2017 or 2016.

#### *Allowance for Loan Losses*

The ALL represents the amount that we believe is necessary to absorb probable losses inherent in the loan portfolio at the balance sheet date and involves a high degree of judgment and complexity. Determination of the ALL is based on an evaluation of the collectability of loans, the realizable value of underlying collateral, economic conditions, historical net loan losses, the estimated loss emergence period, estimated default rates, any declines in cash flow assumptions from acquisition, loan structures, growth factors and other elements that warrant recognition and, to the extent applicable, prior loss experience. The ALL is critical to the portrayal and understanding of our financial condition, liquidity and results of operations. The determination and application of the ALL accounting policy involves judgments, estimates, and uncertainties that are subject to change. Changes in these assumptions, estimates or the conditions surrounding them may have a material impact on our financial condition, liquidity or results of operations.

In accordance with the applicable guidance for business combinations, acquired loans were recorded at their acquisition date fair values, which were based on expected future cash flows and included an estimate for future loan losses; therefore, no ALL was recorded as of the acquisition date. Any estimated losses on acquired loans that arise after the acquisition date are reflected in a charge to the provision for loan losses on the consolidated statements of operations.

Loans accounted for under the accounting guidance provided in ASC 310-30 have been grouped into pools based on the predominant risk characteristics of purpose and/or type of loan. The timing and receipt of expected principal, interest and any other cash flows of these loans are periodically remeasured and the expected future cash flows of the collective pools are compared to the carrying value of the pools. To the extent that the expected future cash flows of each pool is less than the book value of the pool, an allowance for loan losses will be established through a charge to the provision for loan losses. If the remeasured expected future cash flows are greater than the book value of the pools, then the improvement in the expected future cash flows is accreted into interest income over the remaining expected life of the loan pool. During 2017 and 2016, these re-measurements resulted in overall increases in expected cash flows in certain loan pools, which, absent previous valuation allowances within the same pool, are reflected in increased accretion as well as an increased amount of accretable yield and are recognized over the expected remaining lives of the underlying loans as an adjustment to yield.

For all loans not accounted for under ASC 310-30, the determination of the ALL follows a process to determine the appropriate level of ALL that is designed to account for changes in credit quality and other risk factors. This process provides an ALL consisting of a specific allowance component based on certain individually evaluated loans and a general allowance component based on estimates of reserves needed for all other loans, segmented based on similar risk characteristics.

Impaired loans less than \$250,000 are included in the general allowance population. Impaired loans over \$250,000 are subject to individual evaluation on a regular basis to determine the need, if any, to allocate a specific reserve to the impaired loan. Typically, these loans consist of commercial, commercial real estate and agriculture loans and exclude homogeneous loans such as residential real estate and consumer loans. Specific allowances are determined by collectively analyzing:

- the borrower's resources, ability, and willingness to repay in accordance with the terms of the loan agreement;
- the likelihood of receiving financial support from any guarantors;
- the adequacy and present value of future cash flows, less disposal costs, of any collateral; and
- the impact current economic conditions may have on the borrower's financial condition and liquidity or the value of the collateral.

In evaluating the loan portfolio for an appropriate ALL level, unimpaired loans are grouped into segments based on broad characteristics such as primary use and underlying collateral. During 2016, the Company updated the loan classifications in its allowance for loan losses model to include owner occupied commercial real estate and agriculture within the commercial

loan segment and present energy as its own loan class within the commercial segment. The prior periods presentations have been reclassified to conform to the current period presentation. We have identified four primary loan segments that are further stratified into eleven loan classes to provide more granularity in analyzing loss history and to allow for more definitive qualitative adjustments based upon specific factors affecting each loan class. Following are the loan classes within each of the four primary loan segments:

<u>Commercial</u>	<u>Non-owner occupied commercial real estate</u>	<u>Residential real estate</u>	<u>Consumer</u>
Commercial and industrial	Construction	Senior lien	Total Consumer
Owner occupied commercial real estate	Acquisition and development	Junior lien	
Agriculture	Multifamily		
Energy	Non-owner occupied		

Appropriate ALL levels are determined by segment and class utilizing risk ratings, loss history, peer loss history and qualitative adjustments. The qualitative adjustments consider the following risk factors:

- economic/external conditions;
- loan administration, loan structure and procedures;
- risk tolerance/experience;
- loan growth;
- trends;
- concentrations; and
- other.

Management derives an estimated annual loss rate adjusted for an estimated loss emergence period based on historical loss data categorized by segment and class. The loss rates are applied at the loan segment and class level. Our historical loss history began in 2012, resulting in minimal losses in our originated portfolio. In order to address this lack of historical data, we incorporate not only our own historical loss rates since the beginning of 2012, but we also utilize peer historical loss data, including a historical average net charge-off ratio on each loan type, relying on the Uniform Bank Performance Reports compiled by the Federal Financial Institutions Examinations Council (“FFIEC”). We may also apply a long-term estimated loss rate to pass rated credits as necessary to account for inherent risks to the portfolio. For originated loans, we assign a slightly higher portion of our loss history, but still rely on the peer loss history to account for our limited historical data. For acquired loans, we use solely our internal loss history as those loans are more seasoned and more of the actual losses in the portfolio have been from the acquired portfolio.

The collective resulting ALL for loans not accounted for under ASC 310-30 is calculated as the sum of the specific reserves and the general reserves. While these amounts are calculated by individual loan or segment and class, the entire ALL is available for any loan that, in our judgment, should be charged-off.

#### *Non 310-30 ALL*

During 2017, we recorded \$13.1 million of provision for loan losses for loans not accounted for under ASC 310-30, which primarily reflects reserves to support loan growth and specific reserves on certain non-performing loans. Net charge-offs for non ASC 310-30 loans during 2017 totaled \$10.9 million and were primarily due to two energy loans totaling \$7.5 million and one commercial and industrial loan totaling \$2.5 million. Specific reserves on impaired loans totaled \$1.5 million at December 31, 2017.

During 2016, we recorded \$24.5 million of provision for loan losses for loans not accounted for under ASC 310-30, which primarily reflects specific reserves on certain non-performing loans and reserves to support loan growth. The 2016 provision was driven by loan growth and an increase in the energy sector provision of \$18.9 million. Net charge-offs for non ASC 310-30 loans during 2016 totaled \$21.5 million and were driven by \$19.1 million of energy sector loans. Specific reserves on impaired loans totaled \$2.4 million at December 31, 2016.

310-30 ALL

During 2017, loans accounted for under ASC 310-30 had \$154 thousand of recoupment. The recoupment was due to an improvement of expected future cash flows during the period.

During 2016, loans accounted for under ASC 310-30 had \$805 thousand of recoupment. The recoupment was driven by cash flow improvements on a previously impaired agriculture pool.

Total ALL

After considering the above mentioned factors, we believe that the ALL of \$31.3 million and \$29.2 million is adequate to cover probable losses inherent in the loan portfolio at December 31, 2017 and 2016, respectively. However, it is likely that future adjustments to the ALL will be necessary and any changes to the assumptions, circumstances or estimates used in determining the ALL could adversely affect the Company's results of operations, liquidity or financial condition.

The following schedules present, by class stratification, the changes in the ALL during the periods listed.

	As of and for the years ended								
	December 31, 2017			December 31, 2016			December 31, 2015		
	ASC 310-30 loans	Non 310-30 loans	Total	ASC 310-30 loans	Non 310-30 loans	Total	ASC 310-30 loans	Non 310-30 loans	Total
Beginning allowance for loan losses	\$ 225	\$ 28,949	\$ 29,174	\$ 1,077	\$ 26,042	\$ 27,119	\$ 721	\$ 16,892	\$ 17,613
Charge-offs:									
Commercial	—	(10,342)	(10,342)	—	(20,684)	(20,684)	—	(1,911)	(1,911)
Commercial real estate non-owner occupied	—	—	—	(41)	(280)	(321)	—	(222)	(222)
Residential real estate	—	(236)	(236)	—	(408)	(408)	—	(208)	(208)
Consumer	—	(737)	(737)	(6)	(771)	(777)	(10)	(1,196)	(1,206)
Total charge-offs	—	(11,315)	(11,315)	(47)	(22,143)	(22,190)	(10)	(3,537)	(3,547)
Recoveries	—	433	433	—	594	594	—	609	609
Net charge-offs	—	(10,882)	(10,882)	(47)	(21,549)	(21,596)	(10)	(2,928)	(2,938)
(Recoupment) provision for loan loss	(154)	13,126	12,972	(805)	24,456	23,651	366	12,078	12,444
Ending allowance for loan losses	\$ 71	\$ 31,193	\$ 31,264	\$ 225	\$ 28,949	\$ 29,174	\$ 1,077	\$ 26,042	\$ 27,119
Ratio of net charge-offs to average total loans during the period, respectively	0.00%	0.38%	0.36%	0.03%	0.85%	0.80%	0.01%	0.36%	0.12%
Ratio of ALL to total loans outstanding at period end, respectively	0.06%	1.02%	0.98%	0.15%	1.07%	1.02%	0.53%	1.09%	1.05%
Ratio of ALL to total non-performing loans at period end, respectively	0.00%	148.54%	148.88%	0.00%	94.24%	94.98%	0.00%	101.54%	105.74%
Total loans	\$ 120,623	\$ 3,058,324	\$ 3,178,947	\$ 145,852	\$ 2,715,069	\$ 2,860,921	\$ 202,830	\$ 2,384,843	\$ 2,587,673
Average total loans outstanding during the period	\$ 132,130	\$ 2,897,316	\$ 3,029,446	\$ 170,330	\$ 2,530,464	\$ 2,700,794	\$ 209,268	\$ 2,323,527	\$ 2,532,795
Non-performing loans	\$ —	\$ 21,000	\$ 21,000	\$ —	\$ 30,717	\$ 30,717	\$ —	\$ 25,647	\$ 25,647



	As of and for the years ended					
	December 31, 2014			December 31, 2013		
	ASC 310-30 loans	Non 310-30 loans	Total	ASC 310-30 loans	Non 310-30 loans	Total
Beginning allowance for loan losses	\$ 1,280	\$ 11,241	\$ 12,521	\$ 4,652	\$ 10,728	\$ 15,380
Charge-offs:						
Commercial	(3)	(507)	(510)	(717)	(1,654)	(2,371)
Commercial real estate non-owner occupied	—	—	—	(2,801)	(943)	(3,744)
Residential real estate	—	(739)	(739)	(623)	(882)	(1,505)
Consumer	(36)	(783)	(819)	—	(1,001)	(1,001)
Total charge-offs	(39)	(2,029)	(2,068)	(4,141)	(4,480)	(8,621)
Recoveries	—	951	951	—	1,466	1,466
Net charge-offs	(39)	(1,078)	(1,117)	(4,141)	(3,014)	(7,155)
(Recoupment) provision for loan loss	(520)	6,729	6,209	769	3,527	4,296
Ending allowance for loan losses	\$ 721	\$ 16,892	\$ 17,613	\$ 1,280	\$ 11,241	\$ 12,521
Ratio of net charge-offs to average total loans during the period, respectively	0.01%	0.06%	0.05%	0.67%	0.27%	0.41%
Ratio of ALL to total loans outstanding at period end, respectively	0.26%	0.90%	0.81%	0.28%	0.80%	0.68%
Ratio of ALL to total non-performing loans at period end, respectively	0.00%	156.22%	162.89%	8.63%	118.11%	51.43%
Total loans	\$ 279,645	\$ 1,882,764	\$ 2,162,409	\$ 450,880	\$ 1,403,214	\$ 1,854,094
Average total loans outstanding during the period	\$ 361,806	\$ 1,688,197	\$ 2,050,003	\$ 620,709	\$ 1,128,545	\$ 1,749,254
Non-performing loans	\$ —	\$ 10,813	\$ 10,813	\$ 14,827	\$ 9,517	\$ 24,344

The following tables present the allocation of the ALL and the percentage of the total amount of loans in each loan category listed as of the dates presented:

	December 31, 2017			
	Total loans	% of total loans	Related ALL	ALL as a % of total ALL
Commercial	\$ 1,874,605	59.0%	\$ 21,385	68.4%
Commercial real estate non-owner occupied	563,049	17.7%	5,609	17.9%
Residential real estate	716,237	22.5%	3,965	12.7%
Consumer	25,056	0.8%	305	1.0%
Total	\$ 3,178,947	100.0%	\$ 31,264	100.0%

	December 31, 2016			
	Total loans	% of total loans	Related ALL	ALL as a % of total ALL
Commercial	\$ 1,560,430	54.6%	\$ 18,821	64.6%
Commercial real estate non-owner occupied	526,792	18.4%	5,642	19.3%
Residential real estate	744,885	26.0%	4,387	15.0%
Consumer	28,814	1.0%	324	1.1%
Total	\$ 2,860,921	100.0%	\$ 29,174	100.0%

	December 31, 2015			
	Total loans	% of total loans	Related ALL	ALL as a % of total ALL
Commercial	\$ 1,427,420	55.2%	\$ 17,261	63.6%
Commercial real estate non-owner occupied	442,885	17.1%	4,166	15.4%
Residential real estate	684,002	26.4%	5,281	19.5%
Consumer	33,366	1.3%	411	1.5%
Total	\$ 2,587,673	100.0%	\$ 27,119	100.0%

**December 31, 2014**

	<u>Total loans</u>	<u>% of total loans</u>	<u>Related ALL</u>	<u>ALL as a % of total ALL</u>
Commercial	\$ 1,092,885	50.6%	\$ 10,384	59.0%
Commercial real estate non-owner occupied	401,636	18.6%	3,042	17.3%
Residential real estate	632,700	29.2%	3,771	21.4%
Consumer	35,188	1.6%	416	2.4%
Total	<u>\$ 2,162,409</u>	<u>100.0%</u>	<u>\$ 17,613</u>	<u>100.0%</u>

**December 31, 2013**

	<u>Total loans</u>	<u>% of total loans</u>	<u>Related ALL</u>	<u>ALL as a % of total ALL</u>
Commercial	\$ 794,023	42.9%	\$ 6,005	48.0%
Commercial real estate non-owner occupied	423,644	22.8%	1,766	14.1%
Residential real estate	599,924	32.3%	4,259	34.0%
Consumer	36,503	2.0%	491	3.9%
Total	<u>\$ 1,854,094</u>	<u>100.0%</u>	<u>\$ 12,521</u>	<u>100.0%</u>

The ALL allocated to commercial loans increased to 68.4% at December 31, 2017 from 64.6% at December 31, 2016, due to loan growth partially offset by a decrease in specific reserves of \$0.9 million.

*Other Assets*

Significant components of other assets were as follows as of the periods indicated:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>	<u>Increase (decrease)</u>	
			<u>Amount</u>	<u>% Change</u>
Bank-owned life insurance	\$ 64,387	\$ 62,516	\$ 1,871	3.0%
Deferred tax asset	35,630	52,810	(17,180)	(32.5)%
Derivative asset	13,105	11,715	1,390	11.9%
Accrued interest on loans	11,784	10,020	1,764	17.6%
Accrued income taxes receivable	3,992	5,252	(1,260)	(24.0)%
Accrued interest on interest bearing bank deposits and investment securities	2,471	2,542	(71)	(2.8)%
Other miscellaneous assets	7,879	8,345	(466)	(5.6)%
Minority interest in participated other real estate owned	—	1,578	(1,578)	(100.0)%
Total other assets	<u>\$ 139,248</u>	<u>\$ 154,778</u>	<u>\$ (15,530)</u>	<u>(10.0)%</u>

Other assets totaled \$139.2 million and \$154.8 million at December 31, 2017 and 2016, respectively, representing a decrease of \$15.5 million, or 10.0%, year-over-year. The decrease was driven by a re-measurement of the deferred tax asset as a result of “H.R.1”, known as the “Tax Cuts and Jobs Act”, which among other items reduced the federal corporate tax rate to 21% effective January 1, 2018, further discussed in note 19 of our consolidated financial statements. This decrease was partially offset by increases in bank-owned life insurance, accrued interest on loans and the derivative asset. Refer to note 20 of our consolidated financial statements for further discussion of the derivative asset.

### Other Liabilities

Significant components of other liabilities were as follows as of the dates indicated:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>	<u>Increase (decrease)</u>	
			<u>Amount</u>	<u>% Change</u>
Pending loan purchase settlement	\$ 30,181	\$ 5,063	\$ 25,118	496.1%
Accrued expenses	16,172	13,040	3,132	24.0%
Accrued interest payable	5,776	4,973	803	16.1%
Derivative liability	3,758	3,466	292	8.4%
Other miscellaneous liabilities	15,346	10,990	4,356	39.6%
Participant interest in OREO	688	—	688	100.0%
Total other liabilities	<u>\$ 71,921</u>	<u>\$ 37,532</u>	<u>\$ 34,389</u>	<u>91.6%</u>

Other liabilities totaled \$71.9 million and \$37.5 million at December 31, 2017 and 2016, respectively, increasing a combined \$34.4 million, or 91.6%, year-over-year. Pending loan purchase settlement increased due to timing of loan settlements. Other miscellaneous liabilities increased largely due to an increase in derivative collateral reserves of \$4.5 million. Accrued expenses increased \$1.6 million due to increases in bonus accruals and \$1.5 million in various accrued expense categories. Refer to note 20 of our consolidated financial statements for further discussion of the derivative liability.

### Deposits

Deposits from banking clients serve as a primary funding source for our banking operations and our ability to gather and manage deposit levels is critical to our success. Deposits not only provide a low-cost funding source for our loans, but also provide a foundation for the client relationships that are critical to future loan growth. The following table presents information regarding our deposit composition at December 31, 2017 and 2016:

	<u>December 31, 2017</u>		<u>December 31, 2016</u>		<u>Increase (decrease)</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>% Change</u>
Non-interest bearing demand deposits	\$ 902,439	22.7%	\$ 846,744	21.9%	\$ 55,695	6.6%
Interest bearing demand deposits	474,607	11.9%	427,538	11.1%	47,069	11.0%
Savings accounts	472,852	11.9%	376,046	9.7%	96,806	25.7%
Money market accounts	1,011,611	25.4%	1,046,275	27.0%	(34,664)	(3.3)%
Total transaction deposits	2,861,509	71.9%	2,696,603	69.7%	164,906	6.1%
Time deposits < \$100,000	637,789	16.0%	704,673	18.2%	(66,884)	(9.5)%
Time deposits ≥ \$100,000	480,261	12.1%	467,373	12.1%	12,888	2.8%
Total time deposits	1,118,050	28.1%	1,172,046	30.3%	(53,996)	(4.6)%
Total deposits	<u>\$ 3,979,559</u>	<u>100.0%</u>	<u>\$ 3,868,649</u>	<u>100.0%</u>	<u>\$ 110,910</u>	<u>2.9%</u>

The following table shows scheduled maturities of certificates of deposit with denominations greater than or equal to \$100,000 as of December 31, 2017:

	<u>December 31, 2017</u>
Three months or less	\$ 80,903
Over 3 months through 6 months	61,888
Over 6 months through 12 months	129,330
Thereafter	208,140
Total time deposits ≥ \$100,000	<u>\$ 480,261</u>

Total deposits increased \$110.9 million during 2017. Adjusting for the banking center divestitures during the second quarter of 2017, total deposits increased \$213.9 million, or 5.7% from the prior year. Money market accounts and time deposits decreased \$34.7 million and \$54.0 million, from December 31, 2016, respectively, driven by \$19.0 million and \$48.4 million sold from the banking center divestitures, respectively. The mix of transaction deposits (defined as total deposits less time deposits) to total deposits improved to 71.9% at December 31, 2017, from 69.7% at December 31, 2016, as we continued to focus on developing long-term banking relationships.

At December 31, 2017 and 2016, time deposits that were scheduled to mature within 12 months totaled \$684.6 million and \$788.8 million, respectively. Of the \$684.6 million in time deposits scheduled to mature within 12 months at December 31, 2017, \$272.1 million were in denominations of \$100,000 or more, and \$412.5 million were in denominations less than \$100,000. Note 11 to the consolidated financial statements provides a maturity schedule of time deposits outstanding at December 31, 2017.

#### *Other Borrowings*

As of December 31, 2017 and 2016, the Company sold securities under agreements to repurchase totaling \$130.5 million and \$92.0 million, respectively. In addition, as a member of the FHLB, the Bank has access to a line of credit and term financing from the FHLB with total available credit of \$806.7 million. At December 31, 2017 and 2016, the Bank had \$129.1 million and \$25.0 million in term advances from the FHLB, respectively. The term advances have fixed rates between 1.31% - 2.33%, with maturity dates of 2018 - 2020.

#### **Regulatory Capital**

Our subsidiary bank and the holding company are subject to the regulatory capital adequacy requirements of the Federal Reserve Board and the FDIC, as applicable. Failure to meet the minimum capital requirements can initiate certain mandatory and possibly further discretionary actions by regulators that could have a material adverse effect on us. At December 31, 2017 and 2016, our subsidiary bank and the consolidated holding company exceeded all capital ratio requirements under prompt corrective action and other regulatory requirements, as further detailed in note 13 of our consolidated financial statements.

#### **Results of Operations**

Our net income depends largely on net interest income, which is the difference between interest income from interest earning assets and interest expense on interest bearing liabilities. Our results of operations are also affected by provisions for loan losses and non-interest income, such as service charges, bank card income, swap fee income, and gain on sale of mortgages, net. Our primary operating expenses, aside from interest expense, consist of salaries and benefits, occupancy costs, telecommunications data processing expense and intangible asset amortization. Any expenses related to the resolution of problem assets are also included in non-interest expense.

#### *Overview of Results of Operations*

##### *Year ended 2017*

We recorded net income of \$14.6 million, or \$0.53 per diluted share, during 2017, compared to net income of \$23.1 million, or \$0.79 per diluted share, during 2016. Net income during 2017 included a non-cash deferred tax asset re-measurement charge of \$18.5 million due to the enactment of the Tax Cuts and Jobs Act and \$3.2 million in one-time expenses primarily related to the acquisition of Peoples. Adjusting for these items, net income would have been \$35.0 million, or \$1.26 per diluted share. Fully taxable equivalent net interest income totaled \$152.2 million, representing an increase of \$2.4 million from 2016.

Provision for loan loss expense on non 310-30 loans was \$13.1 million during 2017, compared to \$24.5 million during 2016, a decrease of \$11.4 million driven entirely by a reduction in the provision for energy loans. Net charge-offs on non 310-30 loans totaled 0.38%, or 0.12% excluding the energy portfolio.

Non-interest income totaled \$39.2 million during 2017, decreasing \$0.8 million from 2016, due to decreases in OREO related income of \$1.8 million and gain on sale of mortgages, net of \$0.7 million. These decreases were partially offset by a combined increase in services charges and bank card fees of \$1.3 million and other non-interest income of \$0.4 million.

Non-interest expense totaled \$136.7 million during 2017, increasing \$0.7 million from 2016. The increase was largely due to \$3.2 million of one-time expenses primarily related to the Peoples acquisition, offset by decreases of \$1.9 million in

occupancy and equipment, a \$0.5 million decrease in bank card expense and a \$0.5 million decrease in FDIC deposit insurance.

Income tax expense totaled \$21.3 million during 2017 and included an \$18.5 million non-cash deferred tax asset re-measurement charge due to the enactment of the Tax Cuts and Jobs Act, partially offset by \$4.2 million in tax benefits from stock compensation activity. Without these discrete items, tax expense would have been \$7.1 million, an effective tax rate of 19.7%. The lower tax rate compared to the statutory rate reflects the continued success of our tax strategies and tax exempt income in relation to pre-tax income.

#### *Years ended 2016 and 2015*

We recorded net income of \$23.1 million, or \$0.79 per diluted share, during 2016, compared to net income of \$4.9 million, or \$0.14 per diluted share, during 2015. Fully taxable equivalent net interest income totaled \$149.7 million representing a decrease of \$9.9 million from 2015.

Provision for loan loss expense on non 310-30 loans was \$24.5 million during 2016, compared to \$12.1 million during 2015, an increase of \$12.4 million driven by 2016 energy sector provision of \$18.9 million. Net charge-offs on non 310-30 loans totaled 0.85%, or 0.10% excluding the energy portfolio during 2016, compared to 0.12% during 2015.

Non-interest income totaled \$40.0 million during 2016, compared to \$21.4 million during 2015, increasing \$18.6 million. Excluding the net \$14.5 million of negative FDIC-related income and bargain purchase gain in the prior year, non-interest income increased \$4.1 million, or 11.3%, largely due to an increase of \$3.4 million in other non-interest income.

Non-interest expense totaled \$136.0 million during 2016, representing a decrease of \$22.0 million, or 13.9%, from the prior year. The decrease was partially due to lower telecommunications and data processing expense of \$5.5 million, lower salaries and benefits of \$3.3 million, lower marketing expenses of \$1.8 million, lower occupancy and equipment of \$1.6 million and lower professional fees of \$1.0 million. Problem asset workout expense and gain on sale of OREO improved a combined \$4.9 million. Additionally, 2015 included banking center consolidation related expenses of \$1.4 million, and warrant liability expense of \$0.1 million.

#### *Net Interest Income*

We regularly review net interest income metrics to provide us with indicators of how the various components of net interest income are performing. We regularly review: (i) our loan mix and the yield on loans; (ii) the investment portfolio and the related yields; (iii) our deposit mix and the cost of deposits; and (iv) net interest income simulations for various forecast periods.

The following tables present the components of net interest income for the periods indicated. The tables include: (i) the average daily balances of interest earning assets and interest bearing liabilities; (ii) the average daily balances of non-interest earning assets and non-interest bearing liabilities; (iii) the total amount of interest income earned on interest earning assets on a fully taxable equivalent basis; (iv) the total amount of interest expense incurred on interest bearing liabilities; (v) the resultant average yields and rates; (vi) net interest spread; and (vii) net interest margin, which represents the difference between interest income and interest expense, expressed as a percentage of interest earning assets. The effects of trade-date accounting of investment securities for which the cash had not settled are not considered interest earning assets and are excluded from this presentation for time frames prior to their cash settlement, as are the market value adjustments on the investment securities available-for-sale.

The table below presents the components of net interest income on a fully taxable equivalent basis for the years ended December 31, 2017, 2016 and 2015:

	For the year ended December 31, 2017			For the year ended December 31, 2016			For the year ended December 31, 2015		
	Average balance	Interest	Average rate	Average balance	Interest	Average rate	Average balance	Interest	Average rate
Interest earning assets:									
ASC 310-30 loans	\$ 132,130	\$ 22,505	17.03%	\$ 170,330	\$ 33,256	19.52%	\$ 237,453	\$ 47,255	19.90%
Non 310-30 loans FTE <sup>(1)(2)(3)(4)(5)</sup>	2,905,547	120,596	4.15%	2,545,643	100,142	3.93%	2,109,152	86,693	4.11%
Investment securities available-for-sale	875,430	16,615	1.90%	1,035,679	18,991	1.83%	1,327,245	26,398	1.99%
Investment securities held-to-maturity	296,093	8,226	2.78%	382,366	10,674	2.79%	476,924	11,747	2.46%
Other securities	15,249	839	5.50%	14,975	748	4.99%	25,865	1,210	4.68%
Interest earning deposits and securities purchased under agreements to resell	128,871	1,492	1.16%	141,178	718	0.51%	262,500	799	0.30%
Total interest earning assets FTE <sup>(4)</sup>	<u>\$ 4,353,320</u>	<u>\$ 170,273</u>	3.91%	<u>\$ 4,290,171</u>	<u>\$ 164,529</u>	3.84%	<u>\$ 4,439,139</u>	<u>\$ 174,102</u>	3.92%
Cash and due from banks	67,993			63,513			59,526		
Other assets	315,660			332,122			353,344		
Allowance for loan losses	(31,732)			(33,853)			(20,939)		
Total assets	<u>\$ 4,705,241</u>			<u>\$ 4,651,953</u>			<u>\$ 4,831,070</u>		
Interest bearing liabilities:									
Interest bearing demand, savings and money market deposits	\$ 1,895,852	\$ 6,003	0.32%	\$ 1,865,225	\$ 4,985	0.27%	\$ 1,758,965	\$ 4,524	0.26%
Time deposits	1,146,380	10,169	0.89%	1,177,523	8,978	0.76%	1,281,171	9,085	0.71%
Securities sold under agreements to repurchase	88,390	164	0.19%	109,246	152	0.14%	197,728	187	0.09%
Federal Home Loan Bank advances	113,433	1,779	1.57%	45,773	693	1.51%	40,000	666	1.67%
Total interest bearing liabilities	<u>\$ 3,244,055</u>	<u>\$ 18,115</u>	0.56%	<u>\$ 3,197,767</u>	<u>\$ 14,808</u>	0.46%	<u>\$ 3,277,864</u>	<u>\$ 14,462</u>	0.44%
Demand deposits	873,265			818,901			782,431		
Other liabilities	41,205			51,587			69,299		
Total liabilities	<u>4,158,525</u>			<u>4,068,255</u>			<u>4,129,594</u>		
Shareholders' equity	<u>546,716</u>			<u>583,698</u>			<u>701,476</u>		
Total liabilities and shareholders' equity	<u>\$ 4,705,241</u>			<u>\$ 4,651,953</u>			<u>\$ 4,831,070</u>		
Net interest income FTE <sup>(4)</sup>		<u>\$ 152,158</u>			<u>\$ 149,721</u>			<u>\$ 159,640</u>	
Interest rate spread FTE <sup>(4)</sup>			3.35%			3.38%			3.48%
Net interest earning assets	<u>\$ 1,109,265</u>			<u>\$ 1,092,404</u>			<u>\$ 1,161,275</u>		
Net interest margin FTE <sup>(4)</sup>			3.50%			3.49%			3.60%
Ratio of average interest earning assets to average interest bearing liabilities	134.19%			134.16%			135.43%		

- (1) Originated loans are net of deferred loan fees, less costs, which are included in interest income over the life of the loan.
- (2) Includes originated loans with average balances of \$2,779,344, \$2,368,968 and \$1,893,792, interest income of \$106,965, \$85,792 and \$70,569 and tax equivalent yields of 4.06%, 3.79% and 3.87% for the years ended 2017, 2016 and 2015, respectively.
- (3) Non 310-30 loans include loans held-for-sale. Average balances during 2017, 2016 and 2015 were \$8,231, \$15,179 and \$7,097, and interest income was \$523, \$830 and \$589 for the same periods, respectively. Non-accrual and restructured loan balances are included in the average loan balances; however, the forgone interest on non-accrual and restructured loans is not included in the dollar amounts of interest earned.
- (4) Presented on a fully taxable equivalent basis using the statutory tax rate of 35%. The taxable equivalent adjustments included above are \$5,852, \$4,081 and \$2,695 for the years ended 2017, 2016 and 2015, respectively.
- (5) Loan fees included in interest income totaled \$5,208, \$4,734 and \$4,253 during 2017, 2016 and 2015, respectively.

Net interest income totaled \$146.3 million, \$145.6 million and \$156.9 million for the years ended 2017, 2016 and 2015, respectively. On a fully taxable equivalent basis, net interest income totaled \$152.2 million, \$149.7 million and \$159.6 million during 2017, 2016 and 2015, respectively, increasing \$2.4 million during 2017 and decreasing \$9.9 million during 2016, when compared to prior periods. During 2017, the fully taxable equivalent net interest income benefitted from the continued shift of earning assets into the originated loan portfolio partially offset by lower levels of higher-yielding 310-30 loans and a 0.10% increase in the cost of interest bearing liabilities. During 2016, the fully taxable equivalent net interest income decreased due to lower levels of higher-yielding 310-30 loans and investment portfolio paydowns, partially offset by increases in the originated loan portfolio. The fully taxable equivalent net interest margin widened 0.01% to 3.50% during 2017 and narrowed 0.11% to 3.49 during 2016, when compared to prior periods.

Average loans comprised \$3.0 billion, or 69.8%, of total average interest earning assets during 2017, compared to \$2.7 billion, or 63.3%, during 2016 and \$2.3 billion, or 52.9%, during 2015. The increase in average loan balances is reflective of loan originations outpacing the exit of the acquired problem loans and a shifting of investment paydowns into originated loans. The non 310-30 loan portfolio yield increase to 4.15% during 2017, compared to 3.93% during 2016, benefitting from higher yields in our variable rate loans, primarily driven by the short-term market rate increases. The non 310-30 loan portfolio yield decreased to 3.93% during 2016, compared to 4.11% during 2015, due to high originations in a lower rate environment. The yield on the ASC 310-30 loan portfolio was 17.03%, 19.52% and 19.90% during 2017, 2016 and 2015, respectively, decreasing due to the continued resolution of the high yielding ASC 310-30 loan pools.

Average investment securities comprised 26.9%, 33.1% and 40.6% of total interest earning assets during 2017, 2016 and 2015, respectively. The decrease in the investment portfolio was a result of scheduled paydowns and reflects the re-mixing of the interest-earning assets as we have utilized the paydowns of the investment portfolio to fund loan originations. Short-term investments, comprised of the interest earning deposits and securities purchased under agreements to resell, were 3.0%, 3.3% and 5.8% of interest earning assets during 2017, 2016 and 2015, respectively. The 2015 average balance included an increase in cash from temporary client repurchase agreements on deposit from one large client.

Average balances of interest bearing liabilities increased \$46.3 million during 2017, compared to 2016, and decreased \$80.1 million during 2016, compared to 2015. The increase during 2017 was driven by increases in Federal Home Loan Bank advances of \$67.7 million and interest bearing demand, savings and money market deposits of \$30.6 million, partially offset by decreases in time deposits of \$31.1 million and securities sold under agreement to repurchase of \$20.9 million. The decrease during 2016 was driven by a decrease in time deposits of \$103.6 million and securities sold under agreement to repurchase of \$88.5 million, offset by increases of \$106.3 million in interest bearing demand, savings and money market deposits. Adjusting for banking center divestitures during the second quarter of 2017, interest bearing demand, savings and money market deposits increased \$56.5 million and \$109.0 million during 2017 and 2016, respectively, and time deposits increased \$5.7 million and decreased \$99.7 million during 2017 and 2016, respectively, when compared to prior periods. Total interest expense related to interest bearing liabilities was \$18.1 million, \$14.8 million and \$14.5 million during 2017, 2016 and 2015, respectively, at an average cost of 0.56%, 0.46% and 0.44% during 2017, 2016 and 2015, respectively. Additionally, the cost of deposits increased five basis points to 0.41% during 2017, compared to 0.36% during 2016 and 2015, due to higher cost of savings, money market and time deposits.

The following table summarizes the changes in net interest income on a taxable equivalent basis by major category of interest earning assets and interest bearing liabilities, identifying changes related to volume and changes related to rate for 2017, 2016 and 2015:

	The year ended December 31, 2017 compared to the year ended December 31, 2016			The year ended December 31, 2016 compared to the year ended December 31, 2015		
	Increase (decrease) due to			Increase (decrease) due to		
	Volume	Rate	Net	Volume	Rate	Net
<b>Interest income:</b>						
ASC 310-30 loans	\$ (6,506)	\$ (4,245)	\$ (10,751)	\$ (13,105)	\$ (894)	\$ (13,999)
Non 310-30 loans FTE <sup>(1)(2)(3)</sup>	14,938	5,516	20,454	17,171	(3,722)	13,449
Investment securities available-for-sale	(3,041)	665	(2,376)	(5,346)	(2,061)	(7,407)
Investment securities held-to-maturity	(2,397)	(51)	(2,448)	(2,640)	1,567	(1,073)
Other securities	15	76	91	(544)	82	(462)
Interest earning deposits and securities purchased under agreements to resell	(142)	916	774	(617)	536	(81)
Total interest income	<u>\$ 2,867</u>	<u>\$ 2,877</u>	<u>\$ 5,744</u>	<u>\$ (5,081)</u>	<u>\$ (4,492)</u>	<u>\$ (9,573)</u>
<b>Interest expense:</b>						
Interest bearing demand, savings and money market deposits	\$ 97	\$ 921	\$ 1,018	\$ 284	\$ 177	\$ 461
Time deposits	(276)	1,467	1,191	(790)	683	(107)
Securities sold under agreements to repurchase	(39)	51	12	87	(60)	27
Federal Home Loan Bank advances	1,061	25	1,086	(123)	88	(35)
Total interest expense	<u>843</u>	<u>2,464</u>	<u>3,307</u>	<u>(542)</u>	<u>888</u>	<u>346</u>
Net change in net interest income	<u>\$ 2,024</u>	<u>\$ 413</u>	<u>\$ 2,437</u>	<u>\$ (4,539)</u>	<u>\$ (5,380)</u>	<u>\$ (9,919)</u>

- (1) Originated loans are net of deferred loan fees, less costs, which are included in interest income over the life of the loan.
- (2) Non 310-30 loans include loans held-for-sale. Average balances during 2017, 2016 and 2015 were \$8,231, \$15,179 and \$7,097 and interest income was \$523, \$830 and \$589 for the same periods, respectively.
- (3) Presented on a fully taxable equivalent basis using the statutory tax rate of 35%. The taxable equivalent adjustments included above are \$5,852, \$4,081 and \$2,695 for the years ended 2017, 2016 and 2015, respectively.

Below is a breakdown of deposits and the average rates paid during the periods indicated:

	For the three months ended				For the years ended			
	December 31, 2017		December 31, 2016		December 31, 2017		December 31, 2016	
	Average balance	Average rate paid	Average balance	Average rate paid	Average balance	Average rate paid	Average balance	Average rate paid
Non-interest bearing demand	\$ 933,657	0.00%	\$ 835,263	0.00%	\$ 873,265	0.00%	\$ 818,901	0.00%
Interest bearing demand	443,106	0.12%	415,948	0.09%	424,408	0.10%	419,080	0.09%
Money market accounts	1,059,706	0.42%	1,057,908	0.36%	1,042,873	0.39%	1,066,345	0.34%
Savings accounts	454,494	0.40%	370,845	0.27%	428,571	0.35%	379,800	0.27%
Time deposits	1,128,069	0.95%	1,169,325	0.80%	1,146,380	0.89%	1,177,523	0.76%
Total average deposits	<u>\$ 4,019,032</u>	<u>0.44%</u>	<u>\$ 3,849,289</u>	<u>0.38%</u>	<u>\$ 3,915,497</u>	<u>0.41%</u>	<u>\$ 3,861,649</u>	<u>0.36%</u>

#### *Provision for Loan Losses*

The provision for loan losses represents the amount of expense that is necessary to bring the ALL to a level that we deem appropriate to absorb probable losses inherent in the loan portfolio as of the balance sheet date. The ALL is in addition to the remaining purchase accounting marks of \$1.8 million on acquired non 310-30 loans that were established at the time of acquisition. The determination of the ALL, and the resultant provision for loan losses, is subjective and involves significant estimates and assumptions.



Below is a summary of the provision for loan losses recorded in the consolidated statements of operations for the periods indicated:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
(Recoupment) provision for loans accounted for under ASC 310-30	\$ (154)	\$ (805)	\$ 366
Provision for loan losses on non 310-30 loans	<u>13,126</u>	<u>24,456</u>	<u>12,078</u>
Total provision for loan losses	<u>\$ 12,972</u>	<u>\$ 23,651</u>	<u>\$ 12,444</u>

Provision for loan loss expense on non 310-30 loans was \$13.1 million during 2017, compared to \$24.5 million during 2016, a decrease of \$11.4 million driven entirely by a reduction in the provision for energy loans. Net charge-offs on the non 310-30 portfolio during 2017 totaled 0.38%, or 0.12% excluding the energy portfolio. The non 310-30 allowance for loan losses was 1.02% of total non 310-30 loans at December 31, 2017 compared to 1.07% at December 31, 2016.

Provision for loan loss expense on non 310-30 loans was \$24.5 million during 2016, compared to \$12.1 million during 2015. The provision for loan losses on non 310-30 loans during 2016 included energy sector provision of \$18.9 million. Net charge-offs within the non 310-30 portfolio during 2016 totaled \$21.5 million, of which \$19.1 million were from the energy portfolio. Net charge-offs on the non 310-30 portfolio during 2016 totaled 0.85%, or excluding the energy loans, non 310-30 net charge-offs were 0.10% during 2016, compared to net charge-offs of 0.12% in 2015. The non 310-30 allowance for loan losses was 1.07% of total non 310-30 loans at December 31, 2016 compared to 1.09% at December 31, 2015.

During 2017, 2016 and 2015 we recorded recoupments of \$154 thousand, recoupments of \$805 thousand and provision of \$366 thousand, respectively, for loans accounted for under ASC 310-30 in connection with our re-measurements of expected cash flows. The decreases in expected future cash flows are reflected immediately in our financial statements through increased provisions for loan losses. Increases in expected future cash flows are reflected through an increase in accretible yield that is accreted to income in future periods once any previously recorded provision expense has been reversed.

#### *Non-Interest Income*

The table below details the components of non-interest income during 2017, 2016 and 2015, respectively:

	<u>For the years ended December 31,</u>			<u>2017 vs 2016</u>		<u>2016 vs 2015</u>	
	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>Increase (decrease)</u>		<u>Increase (decrease)</u>	
				<u>Amount</u>	<u>% Change</u>	<u>Amount</u>	<u>% Change</u>
Service charges	\$ 14,634	\$ 13,900	\$ 14,798	\$ 734	5.3 %	\$ (898)	(6.1)%
Bank card fees	12,026	11,429	10,898	597	5.2 %	531	4.9 %
Gain on sale of mortgages, net	2,154	2,881	1,963	(727)	(25.2)%	918	46.8 %
Bank-owned life insurance income	1,871	1,861	1,614	10	0.5 %	247	15.3 %
Other non-interest income	8,082	7,708	4,301	374	4.9 %	3,407	79.2 %
OREO related income	438	2,248	2,379	(1,810)	(80.5)%	(131)	(5.5)%
Bargain purchase gain	—	—	1,048	—	0.0 %	(1,048)	(100.0)%
FDIC loss-sharing related	—	—	(15,553)	—	0.0 %	15,553	100.0 %
Total non-interest income	<u>\$ 39,205</u>	<u>\$ 40,027</u>	<u>\$ 21,448</u>	<u>\$ (822)</u>	<u>(2.1)%</u>	<u>\$ 18,579</u>	<u>86.6 %</u>

Non-interest income totaled \$39.2 million, \$40.0 million and \$21.4 million during 2017, 2016 and 2015, respectively. Service charges represent various fees charged to clients for banking services, including fees such as non-sufficient (“NSF”) charges and service charges on deposit accounts. Service charges and bank card fees increased a combined \$1.3 million, or 5.3%, during 2017, compared to 2016, due to higher instances of both business and personal service charges and higher bank card interchange activity, and decreased a combined \$0.4 million during 2016, compared to 2015, largely due to declines in overdraft charges partially offset by higher interchange activity.

Gain on sale of mortgages, net represents gains of mortgage loans held-for-sale and mark-to-market adjustments on mortgage banking derivatives. Gain on sale of mortgages, net decreased \$0.7 million during 2017, compared to 2016, due to lower volumes and increased \$0.9 million during 2016, compared to 2015, due to a higher level of originations.

Other non-interest income increased \$0.4 million during 2017 and \$3.4 million during 2016, when compared to prior periods. The increase in 2017, compared to 2016, was due to a \$2.9 million gain from banking center divestiture in the second quarter of 2017, partially offset by a \$0.4 million decrease in swap-related income and a \$1.8 million gain on sale of a building in the prior year. The increase in 2016, compared to 2015, was largely due to the \$1.8 million gain on sale of a building during the second quarter of 2016, net swap related income increase of \$0.7 million and a \$0.6 million increase in gain on recoveries of acquired loans during 2016.

OREO related income includes rental income and insurance proceeds received on OREO properties and write-ups to the fair-value of collateral that exceed the loan balance at the time of foreclosure. OREO related income decreased \$1.8 million and \$0.1 million during 2017 and 2016, when compared to prior periods. The decrease during 2017 was due to income from one large OREO property in 2016.

During 2015, the Company realized a bargain purchase gain of \$1.0 million resulting from the acquisition of Pine River. FDIC loss-sharing related represents the expense recognized in connection with the actual reimbursement of costs/recoveries related to the resolution of covered assets by the FDIC. The Company terminated its loss-share agreement with the FDIC in the fourth quarter of 2015.

### *Non-Interest Expense*

The table below details non-interest expense for the periods presented:

	For the years ended December 31,			2017 vs 2016		2016 vs 2015	
	2017	2016	2015	Increase (decrease)		Increase (decrease)	
				Amount	% Change	Amount	% Change
Salaries and benefits	\$ 80,188	\$ 79,765	\$ 83,018	\$ 423	0.5 %	\$ (3,253)	(3.9)%
Occupancy and equipment	20,994	22,904	24,490	(1,910)	(8.3)%	(1,586)	(6.5)%
Telecommunications and data processing	7,188	5,970	11,507	1,218	20.4 %	(5,537)	(48.1)%
Marketing and business development	2,683	2,564	4,325	119	4.6 %	(1,761)	(40.7)%
FDIC deposit insurance	2,762	3,236	3,922	(474)	(14.6)%	(686)	(17.5)%
Bank card expense	3,986	4,440	3,701	(454)	(10.2)%	739	20.0 %
Professional fees	3,330	3,496	4,495	(166)	(4.7)%	(999)	(22.2)%
Other non-interest expense	10,360	8,554	11,107	1,806	21.1 %	(2,553)	(23.0)%
Problem asset workout	3,994	3,983	7,317	11	0.3 %	(3,334)	(45.6)%
Gain on OREO sales, net	(4,150)	(4,383)	(2,776)	233	5.3 %	(1,607)	(57.9)%
Intangible asset amortization	5,342	5,480	5,401	(138)	(2.5)%	79	1.5 %
Banking center consolidation related expense	—	—	1,411	—	0.0 %	(1,411)	(100.0)%
Loss from the change in fair value of warrant liability	—	—	106	—	0.0 %	(106)	(100.0)%
Total non-interest expense	<u>\$ 136,677</u>	<u>\$ 136,009</u>	<u>\$ 158,024</u>	<u>\$ 668</u>	<u>0.5 %</u>	<u>\$ (22,015)</u>	<u>(13.9)%</u>

Non-interest expense totaled \$136.7 million, \$136.0 million and \$158.0 million during 2017, 2016 and 2015, respectively. One-time acquisition costs for the full year of 2017 totaled \$2.7 million.

Salaries and benefits is the largest component of non-interest expense. The increase during 2017, compared to 2016, was due to \$1.4 million of acquisition costs and a \$0.5 million accrual for the special \$1,000 bonus payments to 490 associates partially offset by lower staffing levels. The decrease during 2016, compared to 2015, was due to lower staffing levels and decreases in stock compensation expense.

Occupancy and equipment expense decreased \$1.9 million during 2017 and \$1.6 million during 2016, compared to prior periods. The decrease in 2017 was due to lower depreciation expense. The decrease in 2016 was primarily due to lower depreciation expense and benefits realized from the successful negotiation of vendor contracts during 2015.

Telecommunications and data processing expense increased \$1.2 million during 2017 and decreased \$5.5 million during 2016, compared to prior periods. The increase during 2017 was primarily due to \$0.7 million of acquisition related costs. The decrease in 2016 benefited from the core system conversion and favorable vendor contract negotiations during 2015.

Marketing and business development expense increased \$0.1 million during 2017 and decreased \$1.8 million during 2016, compared to prior periods. The decrease during 2016 was due to reduced levels of marketing campaigns in 2016.

FDIC deposit insurance expense decreased during 2017 and 2016, when compared to prior periods, due to lower assessment rates.

Bank card expense decreased \$0.5 million and increased \$0.7 million during 2017 and 2016, respectively, when compared to prior periods, due to the cost of re-issuance of our bank cards with chip reader technology during 2016.

Professional fees decreased \$0.2 million during 2017, when compared to the prior period, and included \$0.4 million of one-time acquisition costs. Professional fees decreased \$1.0 million during 2016, when compared to the prior period, due to one-time core system conversion related expenses completed during the fourth quarter of 2015.

Other non-interest expense increased \$1.8 million and decreased \$2.6 million during 2017 and 2016, respectively, when compared to prior periods. The increase during 2017 was primarily due to increases in unfunded commitment reserves of \$1.1 million, acquisition related costs of \$0.1 million and \$0.6 million of various other expense categories. The decrease during 2016 was largely due to decreases in unfunded commitment reserves of \$1.4 million and other net decreases of \$1.2 million.

Problem asset workout expense is incurred in connection with the resolution process of our acquired problem loans and were consistent during 2017 and 2016. Problem asset workout expense decreased \$3.3 million from 2015 to 2016 due to the successful resolution of problem assets during 2015. Gain on OREO sales, net decreased \$0.2 million during 2017 and increased \$1.6 million during 2016, respectively, due to the sale of several larger assets during 2016.

The Bank consolidated or sold banking centers within the Bank Midwest and Community Banks of Colorado footprints in each of the years 2015 through 2017. Fair value impairment charges of \$1.4 million were realized during 2015 related to banking centers consolidated or sold. No impairment charges were realized during 2016 or 2017. The warrant agreements were amended during 2015 resulting in a reclassification from a liability to equity.

#### *Income taxes*

Income taxes are accounted for in accordance with ASC Topic 740, *Income Taxes*. Under this guidance, deferred income taxes are determined based on the estimated future tax effects of differences between the financial statement and tax basis of assets and liabilities given the provisions of enacted tax laws. ASC Topic 740 requires the establishment of a valuation allowance against the net deferred tax asset unless it is more-likely-than-not that the tax benefit of the deferred tax asset will be realized. For purposes of projecting whether the deferred tax asset will be realized, we consider tax regulations of the jurisdictions in which we operate, estimates of future taxable income, and available tax planning strategies. If tax regulations, operating results, or the ability to implement tax planning strategies varies, adjustments to the carrying value of the deferred tax assets may be required. We believe that it is more likely than not that the results of future operations will generate sufficient taxable income to realize the deferred tax assets.

Income tax expense totaled \$21.3 million, \$2.9 million and \$3.0 million for 2017, 2016 and 2015, respectively. During the fourth quarter of 2017, the Company re-measured its deferred tax asset as a result of the Tax Cuts and Jobs Act, which among other items reduces the federal corporate tax rate to 21% effective January 1, 2018. As a result, income tax expense recorded in 2017 included an \$18.5 million non-cash one-time charge primarily related to this re-measurement. In addition, the tax expense recorded for 2017 and 2016 was lowered by a \$4.2 million and \$2.1 million tax benefit from stock compensation activity, respectively. Without these discrete items, the effective tax rates for 2017 and 2016 were 19.7% and 19.7%, respectively. The tax expense recorded for 2015 included \$3.7 million of non-cash deferred tax asset write-offs in connection with former executive stock-based compensation agreements. Without this \$3.7 million, the Company would have recorded a tax benefit resulting from the increased tax-exempt income sources compared to pre-tax income. The yearly effective tax rates differ from the federal statutory tax rate primarily due to stock compensation activity, interest income from tax-exempt lending, bank-owned life insurance income and the relationship of these items to pre-tax income.

The Company has unvested stock-based compensation awards outstanding at December 31, 2017, including stock options, restricted stock and performance stock units. The strike prices for options range from \$18.09 to \$34.16, with a large portion of the awards having strike prices of \$20.00. The option awards and restricted stock awards vest over a range of a 1-3 year period. The performance stock units cliff vest over a range of 2-3 years and the number of shares issued is determined by the final performance results. Depending on the movement in our stock price, these stock-based compensation awards may create either an excess tax benefit or tax deficiency depending on the relationship between the fair value at the time of vesting or exercise and the estimated fair value recorded at the time of grant. As of December 31, 2017, we had \$3.1 million of deferred tax assets related to stock-based compensation, \$2.3 million of which is associated with executive officers still employed by the Company.

ASC Topic 740 also requires the projected realization of tax benefits related to uncertain tax positions to be evaluated based upon the likelihood of successfully defending those positions. For tax positions meeting the more likely than not threshold, the amount recognized in the financial statements is the largest benefit that has greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. Interest and penalties on uncertain tax positions are recognized as a component of other non-interest expense. If our assessment of whether a tax position meets or no longer meets the more likely than not threshold were to change, adjustments to income tax benefits may be required. As of December 31, 2017 and 2016, we have not identified any uncertain tax positions.

As of December 31, 2017, our marginal tax rate (the rate we pay on each incremental dollar of earnings) was approximately 38%. However, our effective tax rate (income tax expense divided by income before income taxes) for a given period is driven largely by income and expense items that are non-taxable or non-deductible in the calculation of income tax expense. As a result of the Tax Cuts and Jobs Act, effective January 1, 2018, our marginal tax rate reduced to approximately 23%.

### Liquidity and Capital Resources

Liquidity is monitored and managed to ensure that sufficient funds are available to operate our business and pay our obligations to depositors and other creditors, while providing ample available funds for opportunistic and strategic investments. On-balance sheet liquidity is represented by our cash and cash equivalents and unencumbered investment securities, and is detailed in the table below as of December 31, 2017 and 2016:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
Cash and due from banks	\$ 193,297	\$ 152,736
Cash segregated for Peoples acquisition	(36,189)	—
Unsegregated cash and due from banks	157,108	152,736
Interest bearing bank deposits	64,067	—
Unencumbered investment securities, at fair value	637,048	843,061
Total	<u>\$ 858,223</u>	<u>\$ 995,797</u>

Total on-balance sheet liquidity decreased \$137.6 million from December 31, 2016 to December 31, 2017. The decrease was largely due to a planned reduction of \$206.0 million in unencumbered available-for-sale and held-to-maturity securities balances. Included in cash and due from banks on the consolidated statement of financial condition is \$36.2 million of cash segregated for the Peoples acquisition.

Our primary sources of funds are deposits, securities sold under agreements to repurchase, prepayments and maturities of loans and investment securities, the sale of investment securities, and funds provided from operations. We are also a party to a master repurchase agreement with a large financial institution and we anticipate that, through this agreement, we would have access to a significant amount of liquidity. We anticipate having access to other third party funding sources, including the ability to raise funds through the issuance of shares of our common stock or other equity or equity-related securities, incurrence of debt, and federal funds purchased, that may also be a source of liquidity. We anticipate that these sources of liquidity will provide adequate funding and liquidity for at least a 12-month period.

Our primary uses of funds are loan originations, investment security purchases, withdrawals of deposits, settlement of repurchase agreements, capital expenditures, operating expenses, and share repurchases. For additional information regarding

our operating, investing and financing cash flows, see our consolidated statements of cash flows in the accompanying consolidated financial statements.

Exclusive from the investing activities related to acquisitions, our primary investing activities are originations and pay-offs and pay downs of loans and purchases and sales of investment securities. At December 31, 2017, pledgeable investment securities represented our largest source of liquidity. Our available-for-sale investment securities are carried at fair value and our held-to-maturity securities are carried at amortized cost. Our collective investment securities portfolio totaled \$1.1 billion at December 31, 2017, inclusive of pre-tax net unrealized losses of \$15.5 million on the available-for-sale securities portfolio. Additionally, our held-to-maturity securities portfolio had \$2.0 million of pre-tax net unrealized losses at December 31, 2017. The gross unrealized gains and losses are detailed in note 4 of our consolidated financial statements. As of December 31, 2017, our investment securities portfolio consisted primarily of mortgage-backed securities, all of which were issued or guaranteed by U.S. Government agencies or sponsored enterprises. The anticipated repayments and marketability of these securities offer substantial resources and flexibility to meet new loan demand, reinvest in the investment securities portfolio, or provide optionality for reductions in our deposit funding base.

At present, financing activities primarily consist of changes in deposits and repurchase agreements, and advances from the FHLB, in addition to the payment of dividends and the repurchase of our common stock. Maturing time deposits represent a potential use of funds. As of December 31, 2017, \$684.6 million of time deposits were scheduled to mature within 12 months. Based on the current interest rate environment, market conditions, and our consumer banking strategy focusing on both lower cost transaction accounts and term deposits, our strategy is to replace a significant portion of those maturing time deposits with transaction deposits and market-rate time deposits.

Through our relationship with the FHLB, we have pledged qualifying loans and investment securities allowing us to obtain additional liquidity through FHLB advances and lines of credit. FHLB advances and lines of credit available totaled \$935.8 million of which \$129.1 million was used at December 31, 2017. We can obtain additional liquidity through FHLB advances if required. The Bank also has access to federal funds lines of credit with corresponding banks.

The Basel III Capital rules, effective January 1, 2015, changed the components of regulatory capital, changed the way in which risk ratings are assigned to various categories of bank assets, and defined a new Tier 1 common risk-based ratio. In addition, a capital conservation buffer requirement, designed to strengthen an institution's financial resilience during economic cycles through the restriction of capital distributions and other payments, became effective in 2016 with full phase in beginning January 1, 2019. When fully phased-in, the capital conservative buffer adds a 2.5% capital requirement above existing regulatory minimum ratios. Under the Basel III requirements, at December 31, 2017 and 2016, the Company and the Bank met all capital adequacy requirements and the Bank had regulatory capital ratios in excess of the levels established for well-capitalized institutions. For more information on regulatory capital, see note 13 in our consolidated financial statements.

Our shareholders' equity is impacted by earnings, changes in unrealized gains and losses on securities, net of tax, stock-based compensation activity, share repurchases and the payment of dividends.

The Board of Directors has authorized multiple programs to repurchase shares of the Company's common stock from time to time either in open market or in privately negotiated transactions in accordance with applicable regulations of the SEC. We believe that our repurchases could serve to offset any future share issuances for future acquisitions.

On August 5, 2016, the Company announced that its Board of Directors authorized a new program to repurchase up to an additional \$50.0 million of the Company's common stock. The remaining authorization under this program as of December 31, 2017 was \$12.6 million. During 2017, we did not repurchase any shares of our common stock as part of a publicly announced program.

On January 18, 2018, our Board of Directors declared a quarterly dividend of \$0.09 per common share, payable on March 15, 2018 to shareholders of record at the close of business on February 23, 2018.

## Asset/Liability Management and Interest Rate Risk

Management and the Board of Directors are responsible for managing interest rate risk and employing risk management policies that monitor and limit this exposure. Interest rate risk is measured using net interest income simulations and market value of portfolio equity analyses. These analyses use various assumptions, including the nature and timing of interest rate changes, yield curve shape, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, and reinvestment/replacement of asset and liability cash flows.

The principal objective of the Company's asset and liability management function is to evaluate the interest rate risk within the balance sheet and pursue a controlled assumption of interest rate risk while maximizing earnings and preserving adequate levels of liquidity and capital. The asset and liability management function is under the guidance of the Asset Liability Committee from direction of the Board of Directors. The Asset Liability Committee meets monthly to review, among other things, the sensitivity of the Company's assets and liabilities to interest rate changes, local and national market conditions and rates. The Asset Liability Committee also reviews the liquidity, capital, deposit mix, loan mix and investment positions of the Company.

Instantaneous parallel rate shift scenarios are modeled and utilized to evaluate risk and establish exposure limits for acceptable changes in net interest margin. These scenarios, known as rate shocks, simulate an instantaneous change in interest rates and use various assumptions, including, but not limited to, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, reinvestment and replacement of asset and liability cash flows.

We also analyze the economic value of equity as a secondary measure of interest rate risk. This is a complementary measure to net interest income where the calculated value is the result of the market value of assets less the market value of liabilities. The economic value of equity is a longer term view of interest rate risk because it measures the present value of the future cash flows. The impact of changes in interest rates on this calculation is analyzed for the risk to our future earnings and is used in conjunction with the analyses on net interest income.

Our interest rate risk model indicated that the Company was asset sensitive in terms of interest rate sensitivity at December 31, 2017. During 2017, we increased our asset sensitivity as a result of the balance sheet mix towards more variable rate assets, even after adjusting our models for the excess capital deployment. The table below illustrates the impact of an immediate and sustained 200 and 100 basis point increase and a 50 basis point decrease in interest rates on net interest income based on the interest rate risk model at December 31, 2017 and 2016:

Hypothetical shift in interest rates (in bps)	% change in projected net interest income	
	December 31, 2017	December 31, 2016
200	6.93%	5.84%
100	4.82%	3.66%
(50)	(1.46)%	(2.49)%

Many assumptions are used to calculate the impact of interest rate fluctuations. Actual results may be significantly different than our projections due to several factors, including the timing and frequency of rate changes, market conditions and the shape of the yield curve. The computations of interest rate risk shown above do not include actions that management may undertake to manage the risks in response to anticipated changes in interest rates and actual results may also differ due to any actions taken in response to the changing rates.

As part of the asset/liability management strategy to manage primary market risk exposures expected to be in effect in future reporting periods, management has emphasized the origination of shorter duration loans as well as variable rate loans to limit the negative exposure to a rate increase. The strategy with respect to liabilities has been to emphasize transaction accounts, particularly non-interest or low interest bearing non-maturing deposit accounts which are less sensitive to changes in interest rates. In response to this strategy, non-maturing deposit accounts have grown \$216.3 million during 2017, and totaled 71.9% of total deposits at December 31, 2017, compared to 70.4% at December 31, 2016, when adjusted for banking center consolidations. We currently have no brokered time deposits and intend to continue to focus on our strategy of increasing non-interest or low-cost interest bearing non-maturing deposit accounts.

## Off-Balance Sheet Activities

In the normal course of business, we are a party to various contractual obligations, commitments and other off-balance sheet activities that contain credit, market, and operational risk that are not required to be reflected in our consolidated financial statements. The most significant of these are the loan commitments that we enter into to meet the financing needs of clients, including commitments to extend credit, commercial and consumer lines of credit and standby letters of credit. As of December 31, 2017 and 2016, we had loan commitments totaling \$680.8 million and \$602.2 million, respectively, and standby letters of credit that totaled \$7.2 million and \$13.5 million, respectively. Unused commitments do not necessarily represent future credit exposure or cash requirements, as commitments often expire without being drawn upon. We do not anticipate any material losses arising from commitments or contingent liabilities and we do not believe that there are any material commitments to extend credit that represent risks of an unusual nature.

## Contractual Obligations

In addition to the financing commitments detailed above under “Off-Balance Sheet Activities,” in the normal course of business, we enter into contractual obligations that require future cash settlement. The following table summarizes the contractual cash obligations as of December 31, 2017 and the expected timing of those payments:

	Within one year	After one but within three years	After three but within five years	After five years	Total
Federal Home Loan Bank advances	\$ 61,780	\$ 67,335	\$ —	\$ —	\$ 129,115
Operating lease obligations	3,158	6,073	6,143	12,210	27,584
Purchase obligations	6,702	8,102	6,453	—	21,257
Time deposits	684,622	408,414	21,433	3,581	1,118,050
Total	<u>\$ 756,262</u>	<u>\$ 489,924</u>	<u>\$ 34,029</u>	<u>\$ 15,791</u>	<u>\$ 1,296,006</u>

## Impact of Inflation and Changing Prices

The primary impact of inflation on our operations is reflected in increasing operating costs and is reflected in non-interest expense. Unlike most industrial companies, virtually all of our assets and liabilities are monetary in nature. As a result, changes in interest rates have a more significant impact on our performance than do changes in the general rate of inflation and changes in prices. Interest rate changes do not necessarily move in the same direction, nor have the same magnitude, as changes in the prices of goods and services. Although not as critical to the banking industry as many other industries, inflationary factors may have some impact on our ability to grow, total assets, earnings, and capital levels. We do not expect inflation to be a significant factor in our financial results in the near future.

## Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The information called for by this item is provided under the caption *Asset/Liability Management and Interest Rate Risk* in Part I, Item 2-Management's Discussion and Analysis of Financial Condition and Results of Operations and is incorporated herein by reference.

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

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**Report of Independent Registered Public Accounting Firm**

To the Shareholders and Board of Directors  
National Bank Holdings Corporation:

*Opinion on the Consolidated Financial Statements*

We have audited the accompanying consolidated statements of financial condition of National Bank Holdings Corporation and subsidiaries (the “Company”) as of December 31, 2017 and 2016, the related consolidated statements of operations, comprehensive income (loss), changes in shareholders’ equity, and cash flows for each of the years in the three-year period ended December 31, 2017, and the related notes (collectively, the “consolidated financial statements”). In our opinion, the consolidated 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 years in the three-year period ended December 31, 2017, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company’s internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated February 27, 2018 expressed an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.

*Basis for Opinion*

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the 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 consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

**KPMG LLP**

We have served as the Company’s auditor since 2010.

Kansas City, Missouri  
February 27, 2018



**NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES**

Consolidated Statements of Financial Condition

December 31, 2017 and 2016

(In thousands, except share and per share data)

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
<b>ASSETS</b>		
Cash and due from banks	\$ 193,297	\$ 152,736
Interest bearing bank deposits	64,067	—
Cash and cash equivalents	<u>257,364</u>	<u>152,736</u>
Investment securities available-for-sale (at fair value)	855,345	884,232
Investment securities held-to-maturity (fair value of \$256,771 and \$332,573 at December 31, 2017 and December 31, 2016, respectively)	258,730	332,505
Non-marketable securities	15,030	14,949
Loans	3,178,947	2,860,921
Allowance for loan losses	<u>(31,264)</u>	<u>(29,174)</u>
Loans, net	3,147,683	2,831,747
Loans held for sale	4,629	24,187
Other real estate owned	10,491	15,662
Premises and equipment, net	93,708	95,671
Goodwill	59,630	59,630
Intangible assets, net	1,607	6,949
Other assets	139,248	154,778
Total assets	<u>\$ 4,843,465</u>	<u>\$ 4,573,046</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Liabilities:		
Deposits:		
Non-interest bearing demand deposits	\$ 902,439	\$ 846,744
Interest bearing demand deposits	474,607	427,538
Savings and money market	1,484,463	1,422,321
Time deposits	<u>1,118,050</u>	<u>1,172,046</u>
Total deposits	3,979,559	3,868,649
Securities sold under agreements to repurchase	130,463	92,011
Federal Home Loan Bank advances	129,115	38,665
Other liabilities	<u>71,921</u>	<u>37,532</u>
Total liabilities	4,311,058	4,036,857
Shareholders' equity:		
Common stock, par value \$0.01 per share: 400,000,000 shares authorized; 51,518,162 and 51,813,011 shares issued; 26,875,585 and 26,386,583 shares outstanding at December 31, 2017 and December 31, 2016, respectively	515	514
Additional paid-in capital	970,668	984,087
Retained earnings	60,795	55,454
Treasury stock of 24,479,020 and 24,927,157 shares at December 31, 2017 and December 31, 2016, respectively, at cost	<u>(493,329)</u>	<u>(502,104)</u>
Accumulated other comprehensive loss, net of tax	<u>(6,242)</u>	<u>(1,762)</u>
Total shareholders' equity	532,407	536,189
Total liabilities and shareholders' equity	<u>\$ 4,843,465</u>	<u>\$ 4,573,046</u>

*See accompanying notes to the consolidated financial statements.*

**NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES**

Consolidated Statements of Operations  
For the Years Ended December 31, 2017, 2016 and 2015  
(In thousands, except share and per share data)

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Interest and dividend income:			
Interest and fees on loans	\$ 137,249	\$ 129,317	\$ 131,253
Interest and dividends on investment securities	24,841	29,665	38,145
Dividends on non-marketable securities	839	748	1,210
Interest on interest-bearing bank deposits	1,492	718	799
Total interest and dividend income	<u>164,421</u>	<u>160,448</u>	<u>171,407</u>
Interest expense:			
Interest on deposits	16,172	13,963	13,609
Interest on borrowings	1,943	845	853
Total interest expense	<u>18,115</u>	<u>14,808</u>	<u>14,462</u>
Net interest income before provision for loan losses	146,306	145,640	156,945
Provision for loan losses	<u>12,972</u>	<u>23,651</u>	<u>12,444</u>
Net interest income after provision for loan losses	<u>133,334</u>	<u>121,989</u>	<u>144,501</u>
Non-interest income:			
Service charges	14,634	13,900	14,798
Bank card fees	12,026	11,429	10,898
Gain on sale of mortgages, net	2,154	2,881	1,963
Bank-owned life insurance income	1,871	1,861	1,614
Other non-interest income	8,082	7,708	4,301
OREO related income	438	2,248	2,379
Bargain purchase gain	—	—	1,048
FDIC loss-sharing related	—	—	(15,553)
Total non-interest income	<u>39,205</u>	<u>40,027</u>	<u>21,448</u>
Non-interest expense:			
Salaries and benefits	80,188	79,765	83,018
Occupancy and equipment	20,994	22,904	24,490
Telecommunications and data processing	7,188	5,970	11,507
Marketing and business development	2,683	2,564	4,325
FDIC deposit insurance	2,762	3,236	3,922
Bank card expense	3,986	4,440	3,701
Professional fees	3,330	3,496	4,495
Other non-interest expense	10,360	8,554	11,107
Problem asset workout	3,994	3,983	7,317
Gain on OREO sales, net	(4,150)	(4,383)	(2,776)
Intangible asset amortization	5,342	5,480	5,401
Loss from the change in fair value of warrant liability	—	—	106
Banking center consolidation related expense	—	—	1,411
Total non-interest expense	<u>136,677</u>	<u>136,009</u>	<u>158,024</u>
Income before income taxes	<u>35,862</u>	<u>26,007</u>	<u>7,925</u>
Income tax expense	<u>21,283</u>	<u>2,947</u>	<u>3,044</u>
Net income	<u>\$ 14,579</u>	<u>\$ 23,060</u>	<u>\$ 4,881</u>
Income per share—basic	\$ 0.54	\$ 0.81	\$ 0.14
Income per share—diluted	\$ 0.53	\$ 0.79	\$ 0.14
Weighted average number of common shares outstanding:			
Basic	26,928,763	28,313,061	34,349,996
Diluted	27,709,659	29,091,343	34,363,487

*See accompanying notes to the consolidated financial statements.*

**NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES**

Consolidated Statements of Comprehensive Income (Loss)

For the Years Ended December 31, 2017, 2016 and 2015

(In thousands)

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Net income	\$ 14,579	\$ 23,060	\$ 4,881
Other comprehensive loss, net of tax:			
Securities available-for-sale:			
Net unrealized (losses) gains arising during the period, net of tax benefit (expense) of \$1,871, (\$26) and \$2,015 for the years ended 2017, 2016 and 2015, respectively	(3,128)	42	(3,275)
Less: amortization of net unrealized holding gains to income, net of tax benefit of \$828, \$1,166, and \$1,523 for the years ended 2017, 2016 and 2015, respectively	<u>(1,352)</u>	<u>(1,899)</u>	<u>(2,469)</u>
Other comprehensive loss	<u>(4,480)</u>	<u>(1,857)</u>	<u>(5,744)</u>
Comprehensive income (loss)	<u>\$ 10,099</u>	<u>\$ 21,203</u>	<u>\$ (863)</u>

*See accompanying notes to the consolidated financial statements.*

**NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES**

Consolidated Statements of Changes in Shareholders' Equity

For the Years Ended 2017, 2016 and 2015

(In thousands, except share and per share data)

	<u>Common stock</u>	<u>Additional paid-in capital</u>	<u>Retained earnings</u>	<u>Treasury stock</u>	<u>Accumulated other comprehensive income (loss), net</u>	<u>Total</u>
Balance, December 31, 2014	\$ 512	\$ 993,212	\$ 40,528	\$ (245,516)	\$ 5,839	\$ 794,575
Net income	—	—	4,881	—	—	4,881
Stock-based compensation	—	3,349	—	—	—	3,349
Issuance of stock under equity compensation plan, including gain on reissuance of treasury stock of \$96, net	1	(1,701)	—	904	—	(796)
Repurchase of 8,645,836 shares	—	—	—	(175,048)	—	(175,048)
Cash dividends declared (\$0.20 per share)	—	—	(6,739)	—	—	(6,739)
Warrant reclassification	—	3,066	—	—	—	3,066
Other comprehensive loss	—	—	—	—	(5,744)	(5,744)
Balance, December 31, 2015	\$ 513	\$ 997,926	\$ 38,670	\$ (419,660)	\$ 95	\$ 617,544
Net income	—	—	23,060	—	—	23,060
Stock-based compensation	—	3,492	—	—	—	3,492
Issuance of stock under purchase and equity compensation plans, including gain on reissuance of treasury stock of \$4,396, net	1	(13,790)	—	7,588	—	(6,201)
Repurchase of 4,500,936 shares	—	—	—	(93,573)	—	(93,573)
Cash dividends declared (\$0.22 per share)	—	—	(6,276)	—	—	(6,276)
Warrant exercise	—	(3,541)	—	3,541	—	—
Other comprehensive loss	—	—	—	—	(1,857)	(1,857)
Balance, December 31, 2016	\$ 514	\$ 984,087	\$ 55,454	\$ (502,104)	\$ (1,762)	\$ 536,189
Net income	—	—	14,579	—	—	14,579
Stock-based compensation	—	3,648	—	—	—	3,648
Issuance of stock under purchase and equity compensation plans, including gain on reissuance of treasury stock of \$6,118, net	1	(15,134)	—	6,842	—	(8,291)
Cash dividends declared (\$0.34 per share)	—	—	(9,238)	—	—	(9,238)
Warrant exercise	—	(1,933)	—	1,933	—	—
Other comprehensive loss	—	—	—	—	(4,480)	(4,480)
Balance, December 31, 2017	<u>\$ 515</u>	<u>\$ 970,668</u>	<u>\$ 60,795</u>	<u>\$ (493,329)</u>	<u>\$ (6,242)</u>	<u>\$ 532,407</u>

*See accompanying notes to the consolidated financial statements.*

**NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES**  
Consolidated Statements of Cash Flows  
For the Years Ended December 31, 2017, 2016 and 2015  
(In thousands)

	<b>2017</b>	<b>2016</b>	<b>2015</b>
Cash flows from operating activities:			
Net income	\$ 14,579	\$ 23,060	\$ 4,881
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Provision for loan losses	12,972	23,651	12,444
Depreciation and amortization	12,889	14,203	15,502
Current income tax receivable	1,260	4,176	(7,328)
Deferred income taxes	17,180	(176)	(4,241)
Net excess tax (benefit) deficit on stock-based compensation	(4,225)	(2,078)	3,677
Discount accretion, net of premium amortization on securities	2,581	3,067	4,124
Loan accretion	(23,933)	(35,073)	(50,687)
Gain on sale of mortgages, net	(2,154)	(2,881)	(1,963)
Origination of loans held for sale, net of repayments	(85,959)	(114,397)	(99,246)
Proceeds from sales of loans held for sale	101,935	101,098	92,845
Bank-owned life insurance income	(1,871)	(1,861)	(1,614)
Amortization of indemnification asset	—	—	15,878
Gain on the sale of other real estate owned, net	(4,150)	(4,383)	(2,776)
Impairment on other real estate owned	766	298	1,580
Banking center consolidated related expenses	—	—	1,411
Loss (gain) on fixed assets	(2,853)	(1,981)	(28)
Bargain purchase gain	—	—	(1,048)
Stock-based compensation	3,648	3,492	3,349
Decrease in due to FDIC, net	—	—	(37,138)
Decrease (increase) in other assets	6,040	(4,721)	4,871
Increase (decrease) in other liabilities	9,434	(9,430)	7,879
Net cash provided by (used in) operating activities	58,139	(3,936)	(37,628)
Cash flows from investing activities:			
Purchase of FHLB stock	(7,448)	(5,544)	—
Proceeds from redemption of FHLB stock	6,877	7,670	493
Proceeds from redemption of FRB stock	—	4,964	5,320
Proceeds from maturities of investment securities held-to-maturity	71,105	91,376	104,683
Proceeds from maturities of investment securities available-for-sale	224,336	275,448	314,271
Proceeds from sales of investment securities available-for-sale	—	—	29,747
Proceeds from maturities of non-marketable securities	490	490	—
Purchase of investment securities available-for-sale	(202,694)	(4,872)	—
Purchase of investment securities held-to-maturity	—	—	(6,225)
Net increase in loans	(314,008)	(270,585)	(334,798)
(Purchases) sale of premises and equipment, net	(5,617)	690	(5,081)
Purchase of bank-owned life insurance	—	(10,344)	—
Proceeds from sales of loans	38,087	9,231	17,204
Proceeds from sales of other real estate owned	10,355	16,105	15,566
Decrease in FDIC indemnification asset	—	—	18,331
Net cash activity from acquisitions	—	—	22,832
Net cash (used in) provided by investing activities	(178,517)	114,629	182,343
Cash flows from financing activities:			
Net increase (decrease) in deposits	113,796	27,972	(55,654)
Increase (decrease) in repurchase agreements	38,452	(44,512)	2,971
Advances from FHLB	263,129	218,629	—
FHLB payoffs	(172,679)	(219,964)	—
Issuance of stock under purchase and equity compensation plans	(8,395)	(6,201)	(952)
Proceeds from exercise of stock options	104	—	160
Settlement of warrants	—	—	(368)
Payment of dividends	(9,401)	(6,400)	(6,711)
Repurchase of shares	—	(93,573)	(175,048)
Net cash provided by (used in) financing activities	225,006	(124,049)	(235,602)
Increase (decrease) in cash and cash equivalents	104,628	(13,356)	(90,887)
Cash and cash equivalents at beginning of the year	152,736	166,092	256,979
Cash and cash equivalents at end of period	\$ 257,364	\$ 152,736	\$ 166,092
<i>Supplemental disclosure of cash flow information during the period:</i>			
Cash paid for interest	\$ 17,312	\$ 14,154	\$ 13,751
Net tax payments	\$ 127	\$ 2,193	\$ (7,420)
<i>Supplemental schedule of non-cash investing activities:</i>			
Loans transferred to other real estate owned at fair value	\$ 1,800	\$ 6,868	\$ 4,576
Increase (decrease) in loans purchased but not settled	\$ 25,118	\$ (4,873)	\$ (102)
Loans transferred from loans held for sale to loans	\$ 5,736	\$ 5,285	\$ 218

*See accompanying notes to the consolidated financial statements.*

**NATIONAL BANK HOLDINGS CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2017, 2016 and 2015

**Note 1 Basis of Presentation**

National Bank Holdings Corporation ("NBHC" or the "Company") is a bank holding company that was incorporated in the State of Delaware in 2009 with the intent to acquire and operate financial services franchises and other complementary businesses in targeted markets. The Company is headquartered immediately south of Denver, in Greenwood Village, Colorado, and its primary operations are conducted through its wholly owned subsidiary, NBH Bank, (the "Bank"), a Colorado state-chartered bank and a member of the Federal Reserve System. The Company provides a variety of banking products to both commercial and consumer clients through a network of 85 banking centers as of December 31, 2017, located in Colorado and the greater Kansas City region, and through online and mobile banking products and services.

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, NBH Bank. The accompanying consolidated financial statements have been prepared in accordance with GAAP and where applicable, with general practices in the banking industry or guidelines prescribed by bank regulatory agencies. The consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair statement of the results presented. All such adjustments are of a normal recurring nature. All significant intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications of prior years' amounts are made whenever necessary to conform to current period presentation. All amounts are in thousands, except share data, or as otherwise noted.

The Company's significant accounting policies followed in the preparation of the consolidated financial statements are disclosed in note 2. GAAP requires management to make estimates that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosures of contingent assets and liabilities. By their nature, estimates are based on judgment and available information. Management has made significant estimates in certain areas, such as the amount and timing of expected cash flows from assets, the valuation of OREO, the fair value adjustments on assets acquired and liabilities assumed, the valuation of core deposit intangible assets, the valuation of investment securities for other-than-temporary impairment ("OTTI"), the valuation of stock-based compensation, the fair values of financial instruments, the ALL, and contingent liabilities. Because of the inherent uncertainties associated with any estimation process and future changes in market and economic conditions, it is possible that actual results could differ significantly from those estimates.

**Note 2 Summary of Significant Accounting Policies**

**a) Acquisition activities**—The Company accounts for business combinations under the acquisition method of accounting. Assets acquired and liabilities assumed are measured and recorded at fair value at the date of acquisition, including identifiable intangible assets. If the fair value of net assets acquired exceeds the fair value of consideration paid, a bargain purchase gain is recognized at the date of acquisition. Conversely, if the consideration paid exceeds the fair value of the net assets acquired, goodwill is recognized at the acquisition date. Fair values are subject to refinement for up to a maximum of one year after the closing date of an acquisition as information relative to closing date fair values becomes available. Adjustments recorded to the acquired assets and liabilities assumed are applied prospectively in accordance with Accounting Standards Codification ("ASC") 805, *Business Combinations*. The determination of the fair value of loans acquired takes into account credit quality deterioration and probability of loss; therefore, the related ALL is not carried forward at the time of acquisition.

Identifiable intangible assets are recognized separately if they arise from contractual or other legal rights or if they are separable (i.e., capable of being sold, transferred, licensed, rented, or exchanged separately from the entity). Deposit liabilities and the related depositor relationship intangible assets, known as the core deposit intangible assets, may be exchanged in observable exchange transactions. As a result, the core deposit intangible asset is considered identifiable, because the separability criterion has been met.

**b) Cash and cash equivalents**—Cash and cash equivalents include cash, cash items, amounts due from other banks, amounts due from the Federal Reserve Bank of Kansas City, federal funds sold, and interest-bearing bank deposits and segregated

cash held for the acquisition of Peoples, Inc. Refer to note 24 – Subsequent Events of our consolidated financial statements for additional details related to the acquisition.

**c) Investment securities**—Investment securities may be classified in three categories: trading, available-for-sale or held-to-maturity. Management determines the appropriate classification at the time of purchase and reevaluates the classification at each reporting period. Any sales of available-for-sale securities are for the purpose of executing the Company’s asset/liability management strategy, reducing borrowings, funding loan growth, providing liquidity, or eliminating a perceived credit risk in a specific security. Held-to-maturity securities are carried at amortized cost and the available-for-sale securities are carried at estimated fair value. Unrealized gains or losses on securities available-for-sale are reported as accumulated other comprehensive income (loss) (“AOCI”), a component of shareholders’ equity, net of income tax. Gains and losses realized upon sales of securities are calculated using the specific identification method. Premiums and discounts are amortized to interest income over the estimated lives of the securities. Prepayment experience is periodically evaluated and a determination made regarding the appropriate estimate of the future rates of prepayment. When a change in a bond’s estimated remaining life is necessary, a corresponding adjustment is made in the related premium amortization or discount accretion. Purchases and sales of securities, including any corresponding gains or losses, are recognized on a trade-date basis and a receivable or payable is recognized for pending transaction settlements.

Management evaluates all investments for OTTI on a quarterly basis, and more frequently when economic or market conditions warrant such evaluation. Impairment is considered to be other-than-temporary if it is likely that all amounts contractually due will not be received for debt securities and when there is no positive evidence indicating that an investment’s carrying amount is recoverable in the near term for equity securities. When impairment is considered other-than-temporary, the cost basis of the security is written down to fair value, with the impairment charge related to credit included in earnings, while the impairment charge related to all other factors is recognized in OCI. If the Company has the intent to sell the security or it is more likely than not that the Company will be required to sell the security, the entire amount of the OTTI is recorded in earnings. In evaluating whether the impairment is temporary or other than temporary, the Company considers, among other things, the severity and duration of the unrealized loss position; adverse conditions specifically related to the security; changes in expected future cash flows; downgrades in the rating of the security by a rating agency; the failure of the issuer to make scheduled interest or principal payments; whether the Company has the intent to sell the security; and whether it is more likely than not that the Company will be required to sell the security.

**d) Non-marketable securities**—Non-marketable securities include Federal Reserve Bank (“FRB”) stock and Federal Home Loan Bank (“FHLB”) stock. These securities have been acquired for debt facility or regulatory purposes and are carried at cost.

**e) Loans receivable**—Loans receivable include loans originated by the Company and loans that are acquired through acquisitions. Loans originated by the Company are carried at the principal amount outstanding, net of premiums, discounts, unearned income, and deferred loan fees and costs. Loan fees and certain costs of originating loans are deferred and the net amount is amortized over the contractual life of the related loans. Acquired loans are initially recorded at fair value and are accounted for under either ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (see additional information below) or ASC Topic 310, *Receivables*. Non-refundable loan origination and commitment fees, net of direct costs of originating or acquiring loans, and fair value adjustments for acquired loans, are deferred and recognized over the remaining lives of the related loans in accordance with ASC 310-20.

Acquired loans are recorded at their estimated fair value at the time of acquisition and accounted for under either ASC 310-30 or ASC 310. Estimated fair values of acquired loans are based on a discounted cash flow methodology that considers various factors including the type of loan and related collateral, the expected timing of cash flows, classification status, fixed or variable interest rate, term of loan and whether or not the loan is amortizing, and a discount rate reflecting the Company’s assessment of risk inherent in the cash flow estimates. Acquired 310-30 loans are grouped together according to similar characteristics such as type of loan, loan purpose, geography, risk rating and underlying collateral and are treated as distinct pools when applying various valuation techniques and, in certain circumstances, for the ongoing monitoring of the credit quality and performance of the pools. Each pool is accounted for as a single loan for which the integrity is maintained throughout the life of the asset. Discounts created when the loans are recorded at their estimated fair values at acquisition are accreted over the remaining term of the loan as an adjustment to the related loan’s yield. Similar to originated loans described

below, the accrual of interest income on acquired loans that are not accounted for under ASC 310-30 is discontinued when the collection of principal or interest, in whole or in part, is doubtful.

Interest income on acquired loans that are accounted for under ASC Topic 310 and interest income on loans originated by the Company is accrued and credited to income as it is earned using the interest method based on daily balances of the principal amount outstanding. However, interest is generally not accrued on loans 90 days or more past due, unless they are well secured and in the process of collection. Additionally, in certain situations, loans that are not contractually past due may be placed on non-accrual status due to the continued failure to adhere to contractual payment terms by the borrower coupled with other pertinent factors, such as insufficient collateral value or deficient primary and secondary sources of repayment. Accrued interest receivable is reversed when a loan is placed on non-accrual status and payments received generally reduce the carrying value of the loan. Interest is not accrued while a loan is on non-accrual status and interest income is generally recognized on a cash basis only after payment in full of the past due principal and collection of principal outstanding is reasonably assured. A loan may be placed back on accrual status if all contractual payments have been received, or sooner under certain conditions and collection of future principal and interest payments is no longer doubtful.

In the event of borrower default, the Company may seek recovery in compliance with state lending laws, the respective loan agreements, and credit monitoring and remediation procedures that may include modifying or restructuring a loan from its original terms, for economic or legal reasons, to provide a concession to the borrower from their original terms due to borrower financial difficulties in order to facilitate repayment. Such restructured loans are considered “troubled debt restructurings” and are identified in accordance with ASC 310-40, *Troubled Debt Restructurings by Creditors*. Under this guidance, modifications to loans that fall within the scope of ASC 310-30 are not considered troubled debt restructurings, regardless of otherwise meeting the definition of a troubled debt restructuring.

#### *Loans receivable accounted for under ASC 310-30*

The Company accounts for and evaluates acquired loans in accordance with the provisions of ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*. When loans exhibit evidence of credit deterioration since origination and it is probable at the date of acquisition that the Company will not collect all principal and interest payments in accordance with the terms of the loan agreement, the expected shortfall in future cash flows, as compared to the contractual amount due, is recognized as a non-accretable difference. Any excess of expected cash flows over the acquisition date fair value is known as the accretable yield, and is recognized as accretion income over the life of each pool. Contractual fees not expected to be collected are not included in ASC 310-30 contractual cash flows. Should fees be subsequently collected, the cash flows are accounted for as non 310-30 fee income in the period they are received. Loans that are accounted for under ASC 310-30 that meet the criteria for non-accrual of interest or are accounted for on the cost recovery method at the time of acquisition or subsequent to acquisition, may be considered performing, regardless of whether the client is contractually delinquent, if the timing and expected cash flows on the loan pool in which the loan is included can be otherwise reasonably estimated and if collection of the new carrying value of such pool is expected.

The expected cash flows of individual loans accounted for under ASC 310-30 are periodically remeasured utilizing the same cash flow methodology used at the time of acquisition and subsequent decreases to the expected cash flows will generally result in a provision for loan losses charge in the Company’s consolidated statements of operations. Any increases to the loan cash flow projections are recognized within the loan’s respective loan pools on a prospective basis through an increase to the pool’s accretion income over its remaining life once any previously recorded provision expense has been reversed. These cash flow evaluations are inherently subjective as they require material estimates, all of which may be susceptible to significant change.

**f) Loans held for sale**—The Company has elected to record loans originated and intended for sale in the secondary market at estimated fair value. The Company estimates fair value based on quoted market prices for similar loans in the secondary market. Gains or losses are recognized upon sale and are included as a component of gain on sale of mortgages, net in the consolidated statements of operations. Loans held for sale have primarily been fixed rate single-family residential mortgage loans under contract to be sold in the secondary market. In most cases, loans in this category are sold within 45 days. These loans are generally sold with the mortgage servicing rights released. Under limited circumstances, buyers may have recourse to return a purchased loan to the Company. Recourse conditions may include early payoff, early payment default, breach of representations or warranties, or documentation deficiencies.



The Company enters into commitments to originate residential mortgage loans whereby the interest rate on the loan is determined prior to funding (i.e. interest rate lock commitments). Such interest rate lock commitments on mortgage loans to be sold in the secondary market are considered to be derivatives. To protect against the price risk inherent in residential mortgage loan commitments, the Company utilizes both "best efforts" and "mandatory delivery" forward loan sale commitments to mitigate the risk of potential increases or decreases in the values of loans that would result from the change in market rates for such loans. The Company manages the interest rate risk on interest rate lock commitments by entering into forward sale contracts of mortgage backed securities. Such contracts are accounted for as derivatives and are recorded at fair value as derivative assets or liabilities. They are carried on the consolidated statements of financial condition within other assets or other liabilities and changes in fair value are recorded as a component of gain on sale of mortgages, net in the consolidated statements of operations. The gross gains on loan sales are recognized based on new loan commitments with adjustment for price and pair-off activity. Commission expenses on loans held for sale are recognized based on loans closed.

**g) Allowance for loan losses**—The allowance for loan losses represents management’s estimate of probable credit losses inherent in loans, including acquired loans to the extent necessary, as of the balance sheet date. The determination of the ALL takes into consideration, among other matters, the estimated fair value of the underlying collateral, economic conditions, historical net loan losses, the estimated loss emergence period, estimated default rates, any declines in cash flow assumptions from acquisition, loan structures, growth factors and other elements that warrant recognition. In addition, various regulatory agencies, as an integral part of the examination process, periodically review the ALL. Such agencies may require the Company to recognize additions to the ALL or increases to adversely graded classified loans based on their judgments about information available to them at the time of their examinations.

The Company uses an internal risk rating system to indicate credit quality in the loan portfolio. The risk rating system is applied to all loans and uses a series of grades, which reflect management’s assessment of the risk attributable to loans based on an analysis of the borrower’s financial condition and ability to meet contractual debt service requirements. Loans that management perceives to have acceptable risk are categorized as “Pass” loans. The “Special Mention” loans represent loans that have potential credit weaknesses that deserve management’s close attention. Special mention loans include borrowers that have potential weaknesses or unwarranted risks that, unless corrected, may threaten the borrower’s ability to meet debt requirements. However, these borrowers are still believed to have the ability to respond to and resolve the financial issues that threaten their financial situation. Loans classified as “Substandard” are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard loans have a distinct possibility of loss if the deficiencies are not corrected. “Doubtful” loans are loans that management believes the collection of payments in accordance with the terms of the loan agreement is highly questionable and improbable. Loans accounted for under ASC 310-30, despite being 90 days or more past due or internally adversely classified, may be classified as performing upon and subsequent to acquisition, regardless of whether the client is contractually delinquent, if the timing and expected cash flows on the loan pool can be reasonably estimated and if collection of the carrying value of the loan pool loans is reasonably expected. Interest accrual is discontinued on doubtful loans and certain substandard loans that are excluded from ASC 310-30, as is more fully discussed in note 7.

The Company routinely evaluates adversely risk-rated credits for impairment. Impairment, if any, is typically measured for each loan based on a thorough analysis of the most probable source of repayment, including the present value of the loan’s expected future cash flows, the loan’s estimated fair value, or the estimated fair value of the underlying collateral less costs of disposition for collateral dependent loans. General allowances are established for loans with similar characteristics. In this process, general allowance factors are based on an analysis of historical loss and recovery experience, if any, related to originated and acquired loans, as well as certain industry experience, with adjustments made for qualitative or environmental factors that are likely to cause estimated credit losses to differ from historical experience. To the extent that the data supporting such factors has limitations, management’s judgment and experience play a key role in determining the allowance estimates.

Additions to the ALL are made by provisions for loan losses that are charged to operations. The allowance is decreased by charge-offs due to losses and is increased by provisions for loan losses and recoveries. When it is determined that specific loans, or portions thereof, are uncollectible, these amounts are charged off against the ALL. If repayment of the loan is collateral dependent, the fair value of the collateral, less cost to sell, is used to determine charge-off amounts.

The Company maintains an ALL for loans accounted for under ASC 310-30 as a result of impairment to loan pools arising from the periodic re-measurement of these loans. Any impairment in the individual pool is generally recognized in the current period as provision for loan losses. Any improvement in the estimated cash flows, is generally not recognized immediately, but is instead reflected as an adjustment to the related loan pools yield on a prospective basis once any previously recorded impairment has been recaptured.

**h) Premises and equipment**—With the exception of premises and equipment acquired through business combinations, which are initially measured and recorded at fair value, purchased land is stated at cost, and buildings and equipment are carried at cost, including capitalized interest when appropriate, less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful life of the asset. The Company generally assigns depreciable lives of 39 years for buildings, 7 to 15 years for building improvements, and 3 to 7 years for equipment. Leasehold improvements are amortized over the shorter of their estimated useful lives or remaining lease terms. Maintenance and repairs are charged to non-interest expense as incurred. The Company reviews premises and equipment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. An impairment loss is recognized when the sum of the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposal is less than its carrying amount. In the case of a property that is subject to an operating lease that the Company no longer expects to use, a liability is recorded at the cease-use date equal to the remaining lease rentals, adjusted for the effects of any prepaid or deferred items recognized under the lease, and reduced by estimated sublease rentals that could be reasonably obtained for the property, even if the entity does not intend to enter into a sublease. A ratable portion of the sublease allocation is then expensed until the property is subleased. Property and equipment that meet the held-for-sale criteria is recorded at the lower of its carrying amount or fair value less cost to sell and depreciation is ceased.

**i) Goodwill and intangible assets**—Goodwill is established and recorded if the consideration given during an acquisition transaction exceeds the fair value of the net assets received. Goodwill has an indefinite useful life and is not amortized, but is evaluated annually for potential impairment, or when events or circumstances indicate that it is more likely than not that the fair value of the reporting unit is less than its carrying amount. Such events or circumstances may include deterioration in general economic conditions, deterioration in industry or market conditions, an increased competitive environment, a decline in market-dependent multiples or metrics, declining financial performance, entity-specific events or circumstances or a sustained decrease in share price (either in absolute terms or relative to peers). If the Company determines, based upon the qualitative assessment, that it is more likely than not that the fair value of the reporting unit is greater than the carrying amount no additional procedures are performed; however, if the Company determines that it is more likely than not that the fair value of the reporting unit is less than the carrying amount the Company will compare the fair value of the reporting unit to its carrying amount. Any excess of the carrying amount over fair value would indicate a potential impairment and the Company would proceed to perform an additional test to determine whether goodwill has been impaired and calculate the amount of that impairment.

Intangible assets that have finite useful lives, such as core deposit intangibles, are amortized over their estimated useful lives. The Company's core deposit intangible assets represent the value of the anticipated future cost savings that will result from the acquired core deposit relationships versus an alternative source of funding.

Judgment may be used in assessing goodwill and intangible assets for impairment. Estimates of fair value are based on projections of revenues, operating costs and cash flows of the reporting unit considering historical and anticipated future results, general economic and market conditions, as well as the impact of planned business or operational strategies. The valuations use a combination of present value techniques to measure fair value considering market factors. Additionally, judgment is used in determining the useful lives of finite-lived intangible assets. Adverse changes in the economic environment, operations of the reporting unit, or changes in judgments and projections could result in a significantly different estimate of the fair value of the reporting unit and could result in an impairment of goodwill and/or intangible assets.

**j) Other real estate owned**—OREO consists of property that has been foreclosed on or repossessed by deed in lieu of foreclosure. The assets are initially recorded at the fair value of the collateral less estimated costs to sell, with any initial valuation adjustments charged to the ALL. Subsequent downward valuation adjustments, if any, in addition to gains and losses realized on sales and net operating expenses, are recorded in non-interest expense, while any subsequent write-ups are recorded in non-interest income. Costs associated with maintaining property, such as utilities and maintenance, are charged to expense in the period in which they occur, while costs relating to the development and improvement of property are

capitalized to the extent the balance does not exceed fair value. All OREO acquired through acquisition is recorded at fair value, less cost to sell, at the date of acquisition.

**k) Bank-owned life insurance**—The Company purchased or acquired bank-owned life insurance ("BOLI") policies on certain associates of the Company. The Company is the owner and beneficiary of these policies. The BOLI is carried at net realizable value with changes in net realizable value recorded in non-interest income.

**l) Securities purchased under agreements to resell and securities sold under agreements to repurchase**—The Company periodically enters into purchases or sales of securities under agreements to resell or repurchase as of a specified future date. The securities purchased under agreements to resell are accounted for as collateralized financing transactions and are reflected as an asset in the consolidated statements of financial condition. The securities pledged by the counterparties are held by a third party custodian and valued daily. The Company may require additional collateral to ensure full collateralization for these transactions. The repurchase agreements are considered financing agreements and the obligation to repurchase assets sold is reflected as a liability in the consolidated statements of financial condition of the Company. The repurchase agreements are collateralized by debt securities that are under the control of the Company.

**m) Stock-based compensation**—The Company accounts for stock-based compensation in accordance with ASC Topic 718, *Compensation—Stock Compensation* as amended by ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*. The Company grants stock-based awards including stock options, restricted stock and performance stock units. Stock option grants are for a fixed number of common shares and are issued at exercise prices which are not less than the fair value of a share of stock at the date of grant. The options vest over a time period stated in each option agreement and may be subject to other performance vesting conditions, which require the related compensation expense to be recorded ratably over the requisite service period starting when such conditions become probable. Restricted stock is granted for a fixed number of shares, the transferability of which is restricted until such shares become vested according to the terms in the award agreement. Restricted shares may have multiple vesting qualifications, which can include time vesting of a set portion of the restricted shares and performance criterion, such as market criteria that are tied to specified market conditions of the Company's common stock price and performance targets tied to the Company's earnings per share.

The fair value of stock options is measured using a Black-Scholes model. The fair value of time-based restricted stock awards and performance stock units with performance based vesting criteria is based on the Company's stock price on the date of grant. The fair value of performance stock units with market based vesting criteria is measured using a Monte Carlo simulation model. Compensation expense for the portion of the awards that contain performance and service vesting conditions is recognized over the requisite service period based on the fair value of the awards on the grant date. Compensation expense for the portion of the awards that contain a market vesting condition is recognized over the derived service period based on the fair value of the awards on the grant date. The amortization of stock-based compensation reflects any estimated forfeitures, and the expense realized in subsequent periods may be adjusted to reflect the actual forfeitures realized. The outstanding stock options primarily carry a maximum contractual term of ten years. To the extent that any award is forfeited, surrendered, terminated, expires, or lapses without being vested or exercised, the shares of stock subject to such award not delivered as a result thereof are again made available for awards under the Plan.

The Company accounts for all excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) to be recognized in the consolidated statements of operations as a component of income tax expense or benefit and are classified as an operating activity within the Company's consolidated statements of cash flows. The tax effects of exercised, expired or vested awards are treated as discrete items in the reporting period in which they occur and may result in increased volatility in our effective tax rate. Cash paid by the Company when directly withholding shares for tax withholding purposes is classified as a financing activity in the consolidated statements of cash flows.

Prior to the Company's adoption of ASU 2016-09 during 2016, excess tax benefits were recognized in additional paid-in capital and tax deficiencies were recognized either as an offset to accumulated excess tax benefits, if any, or in the consolidated statements of operations. Excess tax benefits were not recognized until the deduction reduced taxes payable.

**n) Warrants**—The Company issued warrants to certain lead investors in 2009 and 2010. During 2015, the outstanding warrant contracts were modified and recorded at fair value as of the modification date using a Black-Scholes model with the change in fair value reported in the statement of operations as non-interest expense. The awards were classified as equity in the Company's consolidated statements of financial condition. Prior to the modification, the exercise price and the number of warrants were subject to certain down-round provisions, whereby certain subsequent equity issuances at a price below the existing exercise price would result in a downward adjustment to the exercise price and an increase in the number of warrants, and as a result, the warrants were historically classified as a liability in the Company's consolidated statements of financial condition with changes in the fair value each period reported in the statements of operations as non-interest expense.

During the first quarter of 2017, the remaining issued warrants were exercised in a non-cash transaction. Refer to the consolidated statements of changes in shareholders' equity for additional details.

**o) Income taxes**—The Company and its subsidiaries file U.S. federal and certain state income tax returns on a consolidated basis. Additionally, the Company and its subsidiaries file separate state income tax returns with various state jurisdictions. The provision for income taxes includes the income tax balances of the Company and all of its subsidiaries.

Deferred tax assets and liabilities are recognized for temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities at enacted tax rates expected to be in effect when such amounts are realized or settled. Deferred tax assets and liabilities are adjusted for the effects of changes in tax rates in the period of change. The Company establishes a valuation allowance when management believes, based on the weight of available evidence, it is more likely than not that some portion of the deferred tax assets will not be realized.

The Company recognizes and measures income tax benefits based upon a two-step model: 1) a tax position must be more likely than not to be sustained based solely on its technical merits in order to be recognized; and 2) the benefit is measured as the largest dollar amount of that position that is more likely than not to be sustained upon settlement. The difference between the benefit recognized for a position in this model and the tax benefit claimed on a tax return is treated as an unrecognized tax benefit. The Company recognizes income tax related interest and penalties in other non-interest expense.

**p) Income per share**—The Company applies the two-class method of computing income per share as certain of the Company's restricted shares are entitled to non-forfeitable dividends and are therefore considered to be a class of participating securities. The two-class method allocates income according to dividends declared and participation rights in undistributed income. Basic income per share is computed by dividing income allocated to common shareholders by the weighted average number of common shares outstanding during each period. Diluted income per common share is computed by dividing income allocated to common shareholders by the weighted average common shares outstanding during the period, plus amounts representing the dilutive effect of stock options outstanding, certain unvested restricted shares, warrants to issue common stock, or other contracts to issue common shares ("common stock equivalents") using the treasury stock method. Common stock equivalents are excluded from the computation of diluted earnings per common share in periods in which they have an anti-dilutive effect.

**q) Interest Rate Swap Derivatives**—The Company carries all derivatives on the statement of financial condition at fair value. All derivative instruments are recognized as either assets or liabilities depending on the rights or obligations under the contracts. All gains and losses on the derivatives due to changes in fair value are recognized in earnings each period.

The Company offers interest rate swap products to certain of its clients to manage potential changes in interest rates. Each contract between the Company and a client is offset with a contract between the Company and an institutional counterparty, thus minimizing the Company's exposure to rate changes. The Company's portfolio consists of a "matched book," and as such, changes in fair value of the swap pairs will largely offset in earnings. In accordance with applicable accounting guidance, if certain conditions are met, a derivative may be designated as (1) a hedge of the exposure to changes in the fair value of a recognized asset or liability, or of an unrecognized firm commitment, that are attributable to a particular risk (referred to as a fair value hedge) or (2) a hedge of the exposure to variability in the cash flows of a recognized asset or liability, or of a forecasted transaction, that is attributable to a particular risk (referred to as a cash flow hedge). The Company documents all hedging relationships at the inception of each hedging relationship and uses industry accepted methodologies and ranges to determine the effectiveness of each hedge. The fair value of the hedged item is calculated using the estimated future cash flows of the hedged item and applying discount rates equal to the market interest rate for the hedged item at the

inception of the hedging relationship (inception benchmark interest rate plus an inception credit spread), adjusted for changes in the designated benchmark interest rate thereafter.

**r) Treasury stock**—When the Company acquires treasury stock, the sum of the consideration paid and direct transaction costs after tax is recognized as a deduction from equity. The cost basis for the reissuance of treasury stock is determined using a first-in, first-out basis. To the extent that the reissuance price is more than the cost basis (gain), the excess is recorded as an increase to additional paid-in capital in the consolidated statements of financial condition. If the reissuance price is less than the cost basis (loss), the difference is recorded to additional paid-in capital to the extent there is a cumulative treasury stock paid-in capital balance. Any loss in excess of the cumulative treasury stock paid-in capital balance is charged to retained earnings.

### **Note 3 Recent Accounting Pronouncements**

**Revenue from Contracts with Customers**—In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*. This update supersedes revenue recognition requirements in ASC Topic 605, *Revenue Recognition*, including most industry-specific revenue recognition guidance in the FASB Accounting Standards Codification. The new guidance stipulates that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides specific steps that entities should apply in order to achieve this principle. The amendments are effective for interim and annual periods beginning after December 15, 2017, with early application permitted for interim and annual periods beginning after December 15, 2016. ASU No. 2014-09 allows for either full retrospective or modified retrospective adoption.

The new guidance does not apply to revenue associated with financial assets and liabilities including loans, leases, securities, and derivatives that are accounted for under other GAAP. Accordingly, the majority of the Company's revenues will not be affected. The Company has completed its review of revenue streams and contracts with customers and has determined certain service charges, bank card fees and real estate sales are within the scope of the ASU, but has not identified changes to the timing or amount of revenue recognition. The Company adopted ASU No. 2014-09 on January 1, 2018 utilizing the modified retrospective approach. Accounting policies and procedures did not change materially since the principals of revenue recognition from the ASU are largely consistent with existing guidance and current practices applied by the Company. The Company continues to assess the expanded revenue disclosure requirements under the new standard.

**Leases**—In February 2016, the FASB issued ASU 2016-02, *Leases*. The guidance in ASU 2016-02 supersedes the lease recognition requirements in ASC Topic 840, *Leases*. The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statements. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. Early adoption of the amendments in the update is permitted. The Company expects to adopt ASU 2016-02 in the first quarter of 2019 and is currently in the process of evaluating the impact of the ASU's adoption on the Company's consolidated financial statements.

**Financial Instruments - Credit Losses**—In June 2016, the FASB issued ASU 2016-13, *Measurement of Credit Losses on Financial Instruments*. This update replaces the current incurred loss methodology for recognizing credit losses with a current expected credit loss model, which 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. This amendment broadens the information that an entity must consider in developing its expected credit loss estimates. Additionally, the update amends the accounting for credit losses for available-for-sale debt securities and purchased financial assets with a more-than-insignificant amount of credit deterioration since origination. This update 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 a company's loan portfolio. The amendments in this update are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption in fiscal years beginning after December 15, 2018 is permitted. The amendment requires the use of the modified

retrospective approach for adoption. The Company is in the process of evaluating the impact of the ASU's adoption on the Company's consolidated financial statements.

**Statement of Cash Flows – Restricted Cash**—In November 2016, the FASB issued ASU 2016-18, *Restricted Cash (a consensus of the FASB Emerging Issues Task Force)*, which addresses classification and presentation of changes in restricted cash on the statement of cash flows. The standard requires an entity's reconciliation of the beginning-of-period and end-of-period total amounts shown on the statement of cash flows to include in cash and cash equivalents amounts general described as restricted cash and restricted cash equivalents. The ASU does not define restricted cash or restricted cash equivalents, but an entity will need to disclose the nature of the restrictions. The ASU is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. Entities should apply this ASU using a retrospective transition method to each period presented. The Company adopted ASU 2016-18 on January 1, 2018 with no material impact to the consolidated financial statements.

**Derivatives and Hedging - Targeted Improvements to Accounting for Hedging Activities**—In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities*. The purpose of this updated guidance is to better align a company's financial reporting for hedging activities with the economic objectives of those activities. ASU 2017-12 is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2018. Early adoption is permitted, including in an interim period. ASU 2017-12 requires a modified retrospective transition method in which the Company will recognize the cumulative effect of the change on the opening balance of each affected component of equity in the consolidated statements of financial condition as of the date of adoption. The Company is in the process of evaluating the impact of the ASU's adoption on the Company's consolidated financial statements; however, the impact is not expected to be material.

**Reclassification of Certain Tax Effects**—In February 2018, the FASB issued ASU 2018-02, *Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. This update allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The amendments eliminate the stranded tax effects that were created as a result of the reduction of historical U.S. federal corporate income tax rate to the newly enacted U.S. federal corporate income tax rate. The update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted, and is to be applied either in the period of adoption or retrospectively to each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. The Company early adopted ASU 2018-02 in the first quarter of 2018, resulting in a \$1.5 million reclassification from accumulated other comprehensive income to retained earnings on the consolidated statement of financial condition and the consolidated statement of changes in shareholders' equity.

The Company reviewed ASU 2016-01, *Financial Instruments - Recognition and Measurement of Financial Assets and Financial Liabilities* (Topic 825), ASU 2016-15, *Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments* and ASU 2017-04, *Intangibles - Goodwill and Other* (Topic 350): *Simplifying the Test for Goodwill Impairment* and ASU 2017-05, *Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets* (Subtopic 610-20) and does not expect the adoption of these pronouncements to have a material impact on its financial statements.

#### **Note 4 Investment Securities**

The Company's investment securities portfolio is comprised of available-for-sale and held-to-maturity investment securities. These investment securities totaled \$1.1 billion at December 31, 2017 and included \$0.8 billion of available-for-sale securities and \$0.3 billion of held-to-maturity securities. At December 31, 2016, investment securities totaled \$1.2 billion and included \$0.9 billion of available-for-sale securities and \$0.3 billion of held-to-maturity securities.

### Available-for-sale

At December 31, 2017 and 2016, the Company held \$855.3 million and \$884.2 million of available-for-sale investment securities, respectively. Available-for-sale securities are summarized as follows as of the dates indicated:

	December 31, 2017			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Mortgage-backed securities (“MBS”):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	\$ 167,269	\$ 2,371	\$ (992)	\$ 168,648
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	702,107	351	(17,228)	685,230
Municipal securities	1,054	—	(6)	1,048
Other securities	419	—	—	419
Total investment securities available-for-sale	<u>\$ 870,849</u>	<u>\$ 2,722</u>	<u>\$ (18,226)</u>	<u>\$ 855,345</u>

	December 31, 2016			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Mortgage-backed securities (“MBS”):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	\$ 223,781	\$ 3,909	\$ (530)	\$ 227,160
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	666,616	2,124	(16,001)	652,739
Municipal securities	3,921	—	(7)	3,914
Other securities	419	—	—	419
Total investment securities available-for-sale	<u>\$ 894,737</u>	<u>\$ 6,033</u>	<u>\$ (16,538)</u>	<u>\$ 884,232</u>

At December 31, 2017 and 2016, mortgage-backed securities represented primarily all of the Company’s available-for-sale investment portfolio and all mortgage-backed securities were backed by government sponsored enterprises (“GSE”) collateral such as Federal Home Loan Mortgage Corporation (“FHLMC”) and Federal National Mortgage Association (“FNMA”), and the government sponsored agency Government National Mortgage Association (“GNMA”).

The tables below summarize the available-for-sale securities with unrealized losses as of the dates shown, along with the length of the impairment period:

	December 31, 2017					
	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Mortgage-backed securities (“MBS”):						
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	\$ 62,178	\$ (408)	\$ 36,086	\$ (584)	\$ 98,264	\$ (992)
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	162,346	(830)	412,967	(16,398)	575,313	(17,228)
Municipal securities	514	(6)	—	—	514	(6)
Total	<u>\$ 225,038</u>	<u>\$ (1,244)</u>	<u>\$ 449,053</u>	<u>\$ (16,982)</u>	<u>\$ 674,091</u>	<u>\$ (18,226)</u>

	December 31, 2016					
	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Mortgage-backed securities (“MBS”):						
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	\$ 100,898	\$ (530)	\$ —	\$ —	\$ 100,898	\$ (530)
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	137,576	(2,976)	385,707	(13,025)	523,283	(16,001)
Municipal securities	3,058	(7)	—	—	3,058	(7)
Total	<u>\$ 241,532</u>	<u>\$ (3,513)</u>	<u>\$ 385,707</u>	<u>\$ (13,025)</u>	<u>\$ 627,239</u>	<u>\$ (16,538)</u>

The unrealized losses in the Company’s investments portfolio at December 31, 2017 were caused by changes in interest rates. The portfolio included 87 securities, having an aggregate fair value of \$674.1 million, which were in an unrealized loss position at December 31, 2017. During the twelve months ended December 31, 2017, the Company recorded \$0.2 million of other-than-temporary impairment (OTTI) included in other non-interest expense on the consolidated statements of operations. The OTTI charge was on a single municipal security, with an aggregated fair value of \$0.3 million at December 31, 2017.

The unrealized losses in the Company’s investment portfolio at December 31, 2016 were caused by changes in interest rates. The portfolio included 61 securities, with an aggregate fair value of \$627.2 million, which were in an unrealized loss position at December 31, 2016.

Management evaluated all of the available-for-sale securities in an unrealized loss position and concluded no OTTI existed at December 31, 2017 and 2016. The Company has no intention to sell these securities before recovery of their amortized cost and believes it will not be required to sell the securities before the recovery of their amortized cost.

Certain securities are pledged as collateral for public deposits, securities sold under agreements to repurchase and to secure borrowing capacity at the Federal Reserve Bank, and Federal Home Loan Bank (“FHLB”), if needed. The fair value of available-for-sale investment securities pledged as collateral totaled \$334.6 million and \$373.7 million at December 31, 2017 and 2016, respectively. Certain investment securities may also be pledged as collateral for the line of credit at the FHLB; at December 31, 2017 or December 31, 2016, no securities were pledged for this purpose.

Mortgage-backed securities do not have a single maturity date and actual maturities may differ from contractual maturities depending on the repayment characteristics and experience of the underlying financial instruments. The estimated weighted average life of the available-for-sale mortgage-backed securities portfolio was 3.4 years and 3.4 years at December 31, 2017 and 2016, respectively. This estimate is based on assumptions and actual results may differ. At December 31, 2017 and 2016, the duration of the total available-for-sale investment portfolio was 3.1 years and 3.2 years, respectively.

As of December 31, 2017, municipal securities with an amortized cost and fair value of \$0.3 million were due in one year, municipal securities with an amortized cost and fair value of \$0.2 million were due after one year through five years, while municipal securities with an amortized cost and fair value of \$0.5 million were due after five years through ten years. Other securities of \$0.4 million as of December 31, 2017, have no stated contractual maturity date.



## Held-to-maturity

At December 31, 2017 and 2016, the Company held \$258.7 million and \$332.5 million of held-to-maturity investment securities, respectively. Held-to-maturity investment securities are summarized as follows as of the dates indicated:

	December 31, 2017			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Mortgage-backed securities ("MBS"):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	\$ 204,352	\$ 151	\$ (455)	\$ 204,048
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	54,378	—	(1,655)	52,723
Total investment securities held-to-maturity	<u>\$ 258,730</u>	<u>\$ 151</u>	<u>\$ (2,110)</u>	<u>\$ 256,771</u>
	December 31, 2016			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Mortgage-backed securities ("MBS"):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	\$ 263,411	\$ 1,685	\$ (234)	\$ 264,862
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	69,094	16	(1,399)	67,711
Total investment securities held-to-maturity	<u>\$ 332,505</u>	<u>\$ 1,701</u>	<u>\$ (1,633)</u>	<u>\$ 332,573</u>

The tables below summarize the held-to-maturity securities with unrealized losses as of the dates shown, along with the length of the impairment period:

	December 31, 2017					
	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Mortgage-backed securities ("MBS"):						
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	\$ 149,182	\$ (220)	\$ 17,506	\$ (235)	\$ 166,688	\$ (455)
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	6,460	(65)	46,264	(1,590)	52,724	(1,655)
Total	<u>\$ 155,642</u>	<u>\$ (285)</u>	<u>\$ 63,770</u>	<u>\$ (1,825)</u>	<u>\$ 219,412</u>	<u>\$ (2,110)</u>
	December 31, 2016					
	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Mortgage-backed securities ("MBS"):						
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	\$ 27,799	\$ (234)	\$ —	\$ —	\$ 27,799	\$ (234)
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	26,992	(357)	32,146	(1,042)	59,138	(1,399)
Total	<u>\$ 54,791</u>	<u>\$ (591)</u>	<u>\$ 32,146</u>	<u>\$ (1,042)</u>	<u>\$ 86,937</u>	<u>\$ (1,633)</u>

The held-to-maturity portfolio included 36 securities, having an aggregate fair value of \$219.4 million, which were in an unrealized loss position at December 31, 2017, compared to 15 securities, with a fair value of \$86.9 million, at December 31, 2016.

Management evaluated all of the held-to-maturity securities in an unrealized loss position and concluded that no OTTI existed at December 31, 2017 or December 31, 2016. The unrealized losses in the Company's investments at December 31, 2017, were caused by changes in interest rates. The Company has no intention to sell these securities before recovery of their amortized cost and believes it will not be required to sell the securities before the recovery of their amortized cost.

The carrying value of held-to-maturity investment securities pledged as collateral totaled \$142.0 million and \$119.2 million at December 31, 2017 and 2016, respectively.

Actual maturities of mortgage-backed securities may differ from scheduled maturities depending on the repayment characteristics and experience of the underlying financial instruments. The estimated weighted average expected life of the held-to-maturity mortgage-backed securities portfolio as of December 31, 2017 and 2016 was 3.1 years and 3.5 years, respectively. This estimate is based on assumptions and actual results may differ. The duration of the total held-to-maturity investment portfolio was 2.8 years and 3.2 years as of December 31, 2017 and 2016, respectively.

#### Note 5 Non-marketable Securities

Non-marketable securities include Federal Reserve Bank stock and FHLB stock. At December 31, 2017, the Company held \$9.2 million of Federal Reserve Bank stock and \$5.8 million of FHLB stock for regulatory or debt facility purposes. At December 31, 2016, the Company held \$9.2 million of Federal Reserve Bank stock, \$5.2 million of FHLB stock and \$0.5 million of non-negotiable certificates of deposit acquired from the Pine River acquisition.

These are restricted securities which, lacking a market, are carried at cost. There have been no identified events or changes in circumstances that may have an adverse effect on the investments carried at cost. Management evaluated all of the non-marketable securities and concluded that no OTTI existed at December 31, 2017 or December 31, 2016.

#### Note 6 Loans

The loan portfolio is comprised of loans originated by the Company and loans that were acquired in connection with the Company's acquisitions.

The tables below show the loan portfolio composition including carrying value by segment of loans accounted for under ASC 310-30, *Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality*, and loans not accounted for under this guidance, which includes our originated loans, as of the dates shown. The carrying value of loans is net of discounts on loans excluded from ASC 310-30, and fees and costs of \$4.3 million and \$6.3 million at December 31, 2017 and 2016, respectively. At December 31, 2016, \$14.4 million of non 310-30 loans were held-for-sale, most of which were in the residential real estate segment. The sale of these loans was completed in connection with the four banking center divestitures in the second quarter of 2017.

	December 31, 2017			
	ASC 310-30 loans	Non 310-30 loans	Total loans	% of total
Commercial	\$ 29,475	\$ 1,845,130	\$ 1,874,605	59.0%
Commercial real estate non-owner occupied	77,908	485,141	563,049	17.7%
Residential real estate	12,759	703,478	716,237	22.5%
Consumer	481	24,575	25,056	0.8%
Total	\$ 120,623	\$ 3,058,324	\$ 3,178,947	100.0%

**December 31, 2016**

	<u>ASC 310-30 loans</u>	<u>Non 310-30 loans</u>	<u>Total loans</u>	<u>% of total</u>
Commercial	\$ 39,280	\$ 1,521,150	\$ 1,560,430	54.6%
Commercial real estate non-owner occupied	89,150	437,642	526,792	18.4%
Residential real estate	16,524	728,361	744,885	26.0%
Consumer	898	27,916	28,814	1.0%
<b>Total</b>	<u>\$ 145,852</u>	<u>\$ 2,715,069</u>	<u>\$ 2,860,921</u>	<u>100.0%</u>

Delinquency for loans excluded from ASC 310-30 is shown in the following tables at December 31, 2017 and 2016:

	<b>December 31, 2017</b>							
	<b>30-59</b>	<b>60-89</b>	<b>Greater</b>			<b>Total</b>	<b>Loans &gt; 90</b>	
	<b>days past</b>	<b>days past</b>	<b>than 90</b>	<b>Total past</b>	<b>Current</b>	<b>non</b>	<b>days past</b>	<b>Non-</b>
Loans excluded from ASC 310-30:								
Commercial:								
Commercial and industrial	\$ 554	\$ 117	\$ 1,389	\$ 2,060	\$ 1,373,962	\$ 1,376,022	\$ 150	\$ 7,767
Owner occupied commercial real estate	696	—	1,983	2,679	270,074	272,753	—	3,478
Agriculture	585	—	701	1,286	137,609	138,895	—	2,003
Energy	—	—	1,645	1,645	55,815	57,460	—	1,645
Total commercial	<u>1,835</u>	<u>117</u>	<u>5,718</u>	<u>7,670</u>	<u>1,837,460</u>	<u>1,845,130</u>	<u>150</u>	<u>14,893</u>
Commercial real estate non-owner occupied:								
Construction	—	—	179	179	107,502	107,681	—	179
Acquisition/development	1,097	—	—	1,097	13,318	14,415	—	—
Multifamily	—	—	—	—	26,947	26,947	—	—
Non-owner occupied	<u>56</u>	<u>—</u>	<u>574</u>	<u>630</u>	<u>335,468</u>	<u>336,098</u>	<u>—</u>	<u>605</u>
Total commercial real estate	<u>1,153</u>	<u>—</u>	<u>753</u>	<u>1,906</u>	<u>483,235</u>	<u>485,141</u>	<u>—</u>	<u>784</u>
Residential real estate:								
Senior lien	1,167	885	1,396	3,448	643,034	646,482	—	4,724
Junior lien	233	91	41	365	56,631	56,996	—	459
Total residential real estate	<u>1,400</u>	<u>976</u>	<u>1,437</u>	<u>3,813</u>	<u>699,665</u>	<u>703,478</u>	<u>—</u>	<u>5,183</u>
Consumer	<u>157</u>	<u>6</u>	<u>5</u>	<u>168</u>	<u>24,407</u>	<u>24,575</u>	<u>—</u>	<u>140</u>
Total loans excluded from ASC 310-30	<u>\$ 4,545</u>	<u>\$ 1,099</u>	<u>\$ 7,913</u>	<u>\$ 13,557</u>	<u>\$ 3,044,767</u>	<u>\$ 3,058,324</u>	<u>\$ 150</u>	<u>\$ 21,000</u>

	<b>December 31, 2016</b>							
	<b>30-59</b>	<b>60-89</b>	<b>Greater</b>			<b>Total</b>	<b>Loans &gt; 90</b>	
	<b>days past</b>	<b>days past</b>	<b>than 90</b>	<b>Total past</b>	<b>Current</b>	<b>non</b>	<b>days past</b>	<b>Non-</b>
Loans excluded from ASC 310-30:								
Commercial:								
Commercial and industrial	\$ 3,134	\$ 4,009	\$ 1,078	\$ 8,221	\$ 1,066,475	\$ 1,074,696	\$ —	\$ 8,688
Owner occupied commercial real estate	583	216	56	855	220,689	221,544	—	2,056
Agriculture	501	—	—	501	134,136	134,637	—	1,905
Energy	2	—	6,548	6,550	83,723	90,273	—	12,645
Total commercial	<u>4,220</u>	<u>4,225</u>	<u>7,682</u>	<u>16,127</u>	<u>1,505,023</u>	<u>1,521,150</u>	<u>—</u>	<u>25,294</u>
Commercial real estate non-owner occupied:								
Construction	—	—	—	—	90,314	90,314	—	—
Acquisition/development	—	—	—	—	13,306	13,306	—	—
Multifamily	—	—	—	—	24,954	24,954	—	—
Non-owner occupied	<u>—</u>	<u>—</u>	<u>28</u>	<u>28</u>	<u>309,040</u>	<u>309,068</u>	<u>—</u>	<u>66</u>
Total commercial real estate	<u>—</u>	<u>—</u>	<u>28</u>	<u>28</u>	<u>437,614</u>	<u>437,642</u>	<u>—</u>	<u>66</u>
Residential real estate:								
Senior lien	888	645	1,458	2,991	672,699	675,690	—	4,522
Junior lien	115	61	22	198	52,473	52,671	—	654
Total residential real estate	<u>1,003</u>	<u>706</u>	<u>1,480</u>	<u>3,189</u>	<u>725,172</u>	<u>728,361</u>	<u>—</u>	<u>5,176</u>
Consumer	<u>83</u>	<u>8</u>	<u>—</u>	<u>91</u>	<u>27,825</u>	<u>27,916</u>	<u>—</u>	<u>181</u>
Total loans excluded from ASC 310-30	<u>\$ 5,306</u>	<u>\$ 4,939</u>	<u>\$ 9,190</u>	<u>\$ 19,435</u>	<u>\$ 2,695,634</u>	<u>\$ 2,715,069</u>	<u>\$ —</u>	<u>\$ 30,717</u>

Loans are considered past due or delinquent when the contractual principal or interest due in accordance with the terms of the loan agreement remains unpaid after the due date of the scheduled payment. Pooled loans accounted for under ASC 310-30 that are 90 days or more past due and still accruing are generally considered to be performing and therefore are not included in the tables above. Non-accrual loans include troubled debt restructurings on non-accrual status.

Non-accrual loans excluded from the scope of ASC 310-30 totaled \$21.0 million at December 31, 2017, representing a decrease of \$9.7 million, or 31.6%, from December 31, 2016, due to charge-offs of two energy loans totaling \$7.5 million and one commercial and industrial loan totaling \$2.5 million. In addition, one previously identified energy loan of \$2.2 million at December 31, 2017 was placed back on accrual during the third quarter of 2017. These decreases were partially offset by one commercial and industrial loan totaling \$3.7 million placed on non-accrual during the fourth quarter of 2017.

Credit exposure for all loans as determined by the Company's internal risk rating system was as follows at December 31, 2017 and 2016:

	December 31, 2017				
	Pass	Special mention	Substandard	Doubtful	Total
Loans excluded from ASC 310-30:					
Commercial:					
Commercial and industrial	\$ 1,349,116	\$ 10,829	\$ 14,824	\$ 1,253	\$ 1,376,022
Owner occupied commercial real estate	250,224	17,030	5,424	75	272,753
Agriculture	118,068	18,824	1,870	133	138,895
Energy	55,814	—	1,646	—	57,460
Total commercial	<u>1,773,222</u>	<u>46,683</u>	<u>23,764</u>	<u>1,461</u>	<u>1,845,130</u>
Commercial real estate non-owner occupied:					
Construction	107,502	—	179	—	107,681
Acquisition/development	14,415	—	—	—	14,415
Multifamily	24,817	—	2,130	—	26,947
Non-owner occupied	333,225	1,396	1,477	—	336,098
Total commercial real estate	<u>479,959</u>	<u>1,396</u>	<u>3,786</u>	<u>—</u>	<u>485,141</u>
Residential real estate:					
Senior lien	641,294	91	5,097	—	646,482
Junior lien	56,172	—	824	—	56,996
Total residential real estate	<u>697,466</u>	<u>91</u>	<u>5,921</u>	<u>—</u>	<u>703,478</u>
Consumer	24,432	1	142	—	24,575
Total loans excluded from ASC 310-30	<u>\$ 2,975,079</u>	<u>\$ 48,171</u>	<u>\$ 33,613</u>	<u>\$ 1,461</u>	<u>\$ 3,058,324</u>
Loans accounted for under ASC 310-30:					
Commercial	\$ 23,954	\$ 1,070	\$ 4,451	\$ —	\$ 29,475
Commercial real estate non-owner occupied	50,537	883	26,488	—	77,908
Residential real estate	10,072	1,055	1,632	—	12,759
Consumer	327	9	145	—	481
Total loans accounted for under ASC 310-30	<u>\$ 84,890</u>	<u>\$ 3,017</u>	<u>\$ 32,716</u>	<u>\$ —</u>	<u>\$ 120,623</u>
Total loans	<u>\$ 3,059,969</u>	<u>\$ 51,188</u>	<u>\$ 66,329</u>	<u>\$ 1,461</u>	<u>\$ 3,178,947</u>

	December 31, 2016				
	Pass	Special mention	Substandard	Doubtful	Total
Loans excluded from ASC 310-30:					
Commercial:					
Commercial and industrial	\$ 1,041,326	\$ 7,243	\$ 25,636	\$ 491	\$ 1,074,696
Owner occupied commercial real estate	202,036	9,371	10,137	—	221,544
Agriculture	123,809	8,922	1,906	—	134,637
Energy	77,619	—	7,811	4,843	90,273
Total commercial	<u>1,444,790</u>	<u>25,536</u>	<u>45,490</u>	<u>5,334</u>	<u>1,521,150</u>
Commercial real estate non-owner occupied:					
Construction	90,099	—	215	—	90,314
Acquisition/development	10,758	2,548	—	—	13,306
Multifamily	22,495	238	2,221	—	24,954
Non-owner occupied	300,922	5,895	2,251	—	309,068
Total commercial real estate	<u>424,274</u>	<u>8,681</u>	<u>4,687</u>	<u>—</u>	<u>437,642</u>
Residential real estate:					
Senior lien	669,148	1,215	5,316	11	675,690
Junior lien	51,250	178	1,243	—	52,671
Total residential real estate	<u>720,398</u>	<u>1,393</u>	<u>6,559</u>	<u>11</u>	<u>728,361</u>
Consumer	27,669	59	188	—	27,916
Total loans excluded from ASC 310-30	<u>\$ 2,617,131</u>	<u>\$ 35,669</u>	<u>\$ 56,924</u>	<u>\$ 5,345</u>	<u>\$ 2,715,069</u>
Loans accounted for under ASC 310-30:					
Commercial	\$ 27,436	\$ 610	\$ 11,234	\$ —	\$ 39,280
Commercial real estate non-owner occupied	38,895	967	45,520	3,768	89,150
Residential real estate	12,477	1,327	2,720	—	16,524
Consumer	721	17	160	—	898
Total loans accounted for under ASC 310-30	<u>\$ 79,529</u>	<u>\$ 2,921</u>	<u>\$ 59,634</u>	<u>\$ 3,768</u>	<u>\$ 145,852</u>
Total loans	<u>\$ 2,696,660</u>	<u>\$ 38,590</u>	<u>\$ 116,558</u>	<u>\$ 9,113</u>	<u>\$ 2,860,921</u>

Non 310-30 special mention loans increased \$12.5 million from December 31, 2016 due to upgrades from substandard and doubtful within the commercial and industrial sector and downgrades from pass within the commercial and industrial sector, partially offset by payoffs in the commercial and industrial and owner-occupied commercial real estate sectors. Non 310-30 substandard loans decreased \$23.3 million from December 31, 2016 primarily due to paydowns and upgrades to special mention and pass within the commercial and industrial, owner-occupied commercial real estate and energy sectors. Non 310-30 doubtful loans decreased \$3.9 million from December 31, 2016 due to energy loan charge-offs during the period.

### ***Impaired Loans***

Loans are considered to be impaired when it is probable that the Company will not be able to collect all amounts due in accordance with the contractual terms of the loan agreement. Impaired loans are comprised of loans excluded from ASC 310-30 on non-accrual status, loans in bankruptcy, and troubled debt restructurings (“TDRs”) described below. If a specific allowance is warranted based on the borrower’s overall financial condition, the specific allowance is calculated based on discounted cash flows using the loan’s initial contractual effective interest rate or the fair value of the collateral less selling costs for collateral dependent loans. At December 31, 2017, the Company measured \$20.3 million of impaired loans based on the fair value of the collateral less selling costs and \$2.3 million of impaired loans using discounted cash flows and the loan’s initial contractual effective interest rate. Impaired loans totaling \$8.3 million that individually were less than \$250 thousand each, were measured through the general ALL reserves due to their relatively small size.

At December 31, 2017 and 2016, the Company’s recorded investment in impaired loans were \$30.9 million and \$38.3 million, respectively, of which \$8.5 million and \$5.8 million, respectively, were accruing TDRs. Impaired loans at December 31, 2017 were primarily comprised of seven relationships totaling \$14.1 million. Four of the relationships were in the commercial and industrial sector totaling \$9.0 million, two of the relationships were in the energy sector totaling \$3.9 million and one relationship was in the agriculture sector totaling \$1.2 million. Impaired loans had a collective related allowance for loan losses allocated to them of \$1.5 million and \$2.4 million at December 31, 2017 and 2016, respectively.

Additional information regarding impaired loans at December 31, 2017 and 2016 is set forth in the table below:

	December 31, 2017			December 31, 2016		
	Unpaid principal balance	Recorded investment	Allowance for loan losses allocated	Unpaid principal balance	Recorded investment	Allowance for loan losses allocated
With no related allowance recorded:						
Commercial:						
Commercial and industrial	\$ 6,481	\$ 5,055	\$ —	\$ 8,671	\$ 7,495	\$ —
Owner occupied commercial real estate	4,186	3,934	—	3,350	3,197	—
Agriculture	1,502	1,245	—	2,044	1,987	—
Energy	8,661	3,861	—	17,142	6,105	—
Total commercial	20,830	14,095	—	31,207	18,784	—
Commercial real estate non-owner occupied:						
Construction	215	179	—	—	—	—
Acquisition/development	—	—	—	—	—	—
Multifamily	29	29	—	33	33	—
Non-owner occupied	901	853	—	394	343	—
Total commercial real estate	1,145	1,061	—	427	376	—
Residential real estate:						
Senior lien	333	309	—	1,551	1,426	—
Junior lien	—	—	—	54	51	—
Total residential real estate	333	309	—	1,605	1,477	—
Consumer	—	—	—	4	4	—
Total impaired loans with no related allowance recorded	\$ 22,308	\$ 15,465	\$ —	\$ 33,243	\$ 20,641	\$ —
With a related allowance recorded:						
Commercial:						
Commercial and industrial	\$ 7,919	\$ 5,339	\$ 1,329	\$ 3,495	\$ 3,464	\$ 492
Owner occupied commercial real estate	873	713	4	957	642	2
Agriculture	2,122	2,083	133	—	—	—
Energy	—	—	—	11,216	6,548	1,866
Total commercial	10,914	8,135	1,466	15,668	10,654	2,360
Commercial real estate non-owner occupied:						
Construction	—	—	—	—	—	—
Acquisition/development	—	—	—	—	—	—
Multifamily	—	—	—	—	—	—
Non-owner occupied	207	200	1	261	255	1
Total commercial real estate	207	200	1	261	255	1
Residential real estate:						
Senior lien	6,481	5,753	24	5,646	5,016	31
Junior lien	1,295	1,179	8	1,781	1,532	14
Total residential real estate	7,776	6,932	32	7,427	6,548	45
Consumer	146	141	1	188	184	2
Total impaired loans with a related allowance recorded	\$ 19,043	\$ 15,408	\$ 1,500	\$ 23,544	\$ 17,641	\$ 2,408
Total impaired loans	\$ 41,351	\$ 30,873	\$ 1,500	\$ 56,787	\$ 38,282	\$ 2,408

The table below shows additional information regarding the average recorded investment and interest income recognized on impaired loans for the periods presented:

	For the years ended					
	December 31, 2017		December 31, 2016		December 31, 2015	
	Average recorded investment	Interest income recognized	Average recorded investment	Interest income recognized	Average recorded investment	Interest income recognized
With no related allowance recorded:						
Commercial:						
Commercial and industrial	\$ 5,609	\$ 152	\$ 7,909	\$ 252	\$ 5,049	\$ 266
Owner occupied commercial real estate	4,155	80	3,249	92	2,221	83
Agriculture	1,422	244	1,830	—	1,961	—
Energy	8,004	156	12,565	—	5,679	—
Total Commercial	19,190	632	25,553	344	14,910	349
Commercial real estate non-owner occupied:						
Construction	—	—	—	—	188	—
Acquisition/development	—	—	—	—	—	—
Multifamily	—	—	—	—	—	—
Non-owner occupied	878	22	368	22	157	—
Total commercial real estate	878	22	368	22	345	—
Residential real estate:						
Senior lien	326	—	1,466	19	956	15
Junior lien	—	—	54	2	113	—
Total residential real estate	326	—	1,520	21	1,069	15
Consumer	—	—	4	—	—	—
Total impaired loans with no related allowance recorded	\$ 20,394	\$ 654	\$ 27,445	\$ 387	\$ 16,324	\$ 363
With a related allowance recorded:						
Commercial:						
Commercial and industrial	\$ 7,331	\$ —	\$ 3,545	\$ 198	\$ 6,273	\$ 1
Owner occupied commercial real estate	747	20	703	20	1,230	27
Agriculture	2,092	5	162	5	276	4
Energy	—	—	10,008	—	3,092	—
Total Commercial	10,170	25	14,418	223	10,871	32
Commercial real estate non-owner occupied:						
Construction	188	—	—	—	—	—
Acquisition/development	—	—	—	—	—	—
Multifamily	30	1	34	2	60	1
Non-owner occupied	213	9	268	13	1,667	48
Total commercial real estate	431	10	302	15	1,727	49
Residential real estate:						
Senior lien	5,986	67	5,200	88	5,911	119
Junior lien	1,225	42	1,600	56	1,725	51
Total residential real estate	7,211	109	6,800	144	7,636	170
Consumer	163	—	196	—	92	1
Total impaired loans with a related allowance recorded	\$ 17,975	\$ 144	\$ 21,716	\$ 382	\$ 20,326	\$ 252
Total impaired loans	\$ 38,369	\$ 798	\$ 49,161	\$ 769	\$ 36,650	\$ 615

Interest income recognized on impaired loans noted in the table above, primarily represents interest earned on accruing troubled debt restructurings. Interest income recognized on impaired loans during the years ended December 31, 2017, 2016 and 2015 was \$0.8 million, \$0.8 million and \$0.6 million, respectively.

#### *Troubled debt restructurings*

The Company's policy is to review each prospective credit to determine the appropriateness and the adequacy of security or collateral prior to making a loan. In the event of borrower default, the Company seeks recovery in compliance with lending laws, the respective loan agreements, and credit monitoring and remediation procedures that may include restructuring a loan

to provide a concession by the Company to the borrower from their original terms due to borrower financial difficulties in order to facilitate repayment. Additionally, if a borrower's repayment obligation has been discharged by a court, and that debt has not been reaffirmed by the borrower, regardless of past due status, the loan is considered to be a TDR.

Non-accruing TDRs at December 31, 2017 and 2016 totaled \$7.3 million and \$16.7 million, respectively.

During 2017, the Company restructured eleven loans with a recorded investment of \$2.1 million at December 31, 2017 to facilitate repayment. All of the loan modifications were a reduction of the principal payment, a reduction in interest rate, or an extension of term. Loan modifications to loans accounted for under ASC 310-30 are not considered TDRs. The tables below provide additional information related to accruing TDRs at December 31, 2017 and 2016:

	December 31, 2017			
	Recorded investment	Average year-to-date recorded investments	Unpaid principal balance	Unfunded commitments to fund TDRs
Commercial	\$ 6,595	\$ 7,308	\$ 7,171	\$ 2,041
Commercial real estate non-owner occupied	455	489	500	—
Residential real estate	1,409	1,461	1,420	2
Consumer	1	3	1	—
Total	<u>\$ 8,460</u>	<u>\$ 9,261</u>	<u>\$ 9,092</u>	<u>\$ 2,043</u>

	December 31, 2016			
	Recorded investment	Average year-to-date recorded investments	Unpaid principal balance	Unfunded commitments to fund TDRs
Commercial	\$ 3,302	\$ 3,440	\$ 3,464	\$ 100
Commercial real estate non-owner occupied	538	572	590	—
Residential real estate	1,920	1,996	1,969	2
Consumer	7	9	7	—
Total	<u>\$ 5,767</u>	<u>\$ 6,017</u>	<u>\$ 6,030</u>	<u>\$ 102</u>

The following table summarizes the Company's carrying value of non-accrual TDRs as of December 31, 2017 and 2016:

	December 31, 2017	December 31, 2016
Commercial	\$ 5,808	\$ 15,265
Commercial real estate non-owner occupied	—	—
Residential real estate	1,336	1,301
Consumer	111	142
Total non-accruing TDRs	<u>\$ 7,255</u>	<u>\$ 16,708</u>

At December 31, 2017 and 2016, the Company had \$8.5 million and \$5.8 million, respectively, of accruing TDRs that had been restructured from the original terms in order to facilitate repayment. Accrual of interest is resumed on loans that were on non-accrual only after the loan has performed sufficiently. The Company had three TDRs that were modified within the past twelve months and had defaulted on their restructured terms. The defaulted TDRs consisted of two commercial loans totaling \$3.2 million, and one small residential loan. Non-accruing TDRs decreased \$9.4 million from December 31, 2016 due to charge-offs within the commercial loan segment. The allowance for loan losses related to troubled debt restructurings on non-accrual status is determined by individual evaluation, including collateral adequacy, using the same process as loans on non-accrual status which are not classified as troubled debt restructurings.

During 2016, the Company had five TDRs that were modified within the past twelve months and had defaulted on their restructured terms. The defaulted TDRs consisted of two commercial loans totaling \$6.4 million and three residential loans totaling \$0.4 million. For purposes of this disclosure, the Company considers "default" to mean 90 days or more past due on principal or interest.

#### *Loans accounted for under ASC 310-30*

Loan pools accounted for under ASC Topic 310-30 are periodically re-measured to determine expected future cash flows. In determining the expected cash flows, the timing of cash flows and prepayment assumptions for smaller homogeneous loans are based on statistical models that take into account factors such as the loan interest rate, credit profile of the borrowers, the



years in which the loans were originated, and whether the loans are fixed or variable rate loans. Prepayments may be assumed on loans if circumstances specific to that loan warrant a prepayment assumption. The re-measurement of loans accounted for under ASC 310-30 resulted in the following changes in the carrying amount of accretable yield during 2017 and 2016:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
Accretable yield beginning balance	\$ 60,476	\$ 84,194
Reclassification from non-accretable difference	11,398	14,316
Reclassification to non-accretable difference	(2,801)	(4,778)
Accretion	<u>(22,505)</u>	<u>(33,256)</u>
Accretable yield ending balance	<u>\$ 46,568</u>	<u>\$ 60,476</u>

Below is the composition of the net book value for loans accounted for under ASC 310-30 at December 31, 2017 and 2016:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
Contractual cash flows	\$ 489,892	\$ 537,611
Non-accretable difference	(322,701)	(331,283)
Accretable yield	<u>(46,568)</u>	<u>(60,476)</u>
Loans accounted for under ASC 310-30	<u>\$ 120,623</u>	<u>\$ 145,852</u>

#### Note 7 Allowance for Loan Losses

The tables below detail the Company's allowance for loan losses and recorded investment in loans as of and for the years ended December 31, 2017 and 2016:

	<u>Year ended December 31, 2017</u>				
	<u>Commercial</u>	<u>Non-owner occupied commercial real estate</u>	<u>Residential real estate</u>	<u>Consumer</u>	<u>Total</u>
Beginning balance	\$ 18,821	\$ 5,642	\$ 4,387	\$ 324	\$ 29,174
Non 310-30 beginning balance	18,821	5,422	4,387	319	28,949
Charge-offs	(10,342)	—	(236)	(737)	(11,315)
Recoveries	99	20	129	185	433
Provision	12,762	141	(315)	538	13,126
Non 310-30 ending balance	<u>21,340</u>	<u>5,583</u>	<u>3,965</u>	<u>305</u>	<u>31,193</u>
ASC 310-30 beginning balance	—	220	—	5	225
Charge-offs	—	—	—	—	—
Recoveries	—	—	—	—	—
Provision (recoupment)	45	(194)	—	(5)	(154)
ASC 310-30 ending balance	<u>45</u>	<u>26</u>	<u>—</u>	<u>—</u>	<u>71</u>
Ending balance	<u>\$ 21,385</u>	<u>\$ 5,609</u>	<u>\$ 3,965</u>	<u>\$ 305</u>	<u>\$ 31,264</u>
Ending allowance balance attributable to:					
Non 310-30 loans individually evaluated for impairment	\$ 1,466	\$ 2	\$ 32	\$ 1	\$ 1,501
Non 310-30 loans collectively evaluated for impairment	19,874	5,581	3,933	304	29,692
ASC 310-30 loans	45	26	—	—	71
Total ending allowance balance	<u>\$ 21,385</u>	<u>\$ 5,609</u>	<u>\$ 3,965</u>	<u>\$ 305</u>	<u>\$ 31,264</u>
Loans:					
Non 310-30 individually evaluated for impairment	\$ 22,232	\$ 1,260	\$ 7,240	\$ 141	\$ 30,873
Non 310-30 collectively evaluated for impairment	1,822,898	483,881	696,238	24,434	3,027,451
ASC 310-30 loans	29,475	77,908	12,759	481	120,623
Total loans	<u>\$ 1,874,605</u>	<u>\$ 563,049</u>	<u>\$ 716,237</u>	<u>\$ 25,056</u>	<u>\$ 3,178,947</u>

Year ended December 31, 2016

	Commercial	Non-owner occupied commercial real estate	Residential real estate	Consumer	Total
Beginning balance	\$ 17,261	\$ 4,166	\$ 5,281	\$ 411	\$ 27,119
Non 310-30 beginning balance	16,473	3,939	5,245	385	26,042
Charge-offs	(20,684)	(280)	(408)	(771)	(22,143)
Recoveries	89	123	108	274	594
Provision	22,943	1,640	(558)	431	24,456
Non 310-30 ending balance	18,821	5,422	4,387	319	28,949
ASC 310-30 beginning balance	788	227	36	26	1,077
Charge-offs	—	(41)	—	(6)	(47)
Recoveries	—	—	—	—	—
(Recoupment) provision	(788)	34	(36)	(15)	(805)
ASC 310-30 ending balance	—	220	—	5	225
Ending balance	<u>\$ 18,821</u>	<u>\$ 5,642</u>	<u>\$ 4,387</u>	<u>\$ 324</u>	<u>\$ 29,174</u>
Ending allowance balance attributable to:					
Non 310-30 loans individually evaluated for impairment	\$ 2,360	\$ 1	\$ 46	\$ 2	\$ 2,409
Non 310-30 loans collectively evaluated for impairment	16,461	5,421	4,341	317	26,540
ASC 310-30 loans	—	220	—	5	225
Total ending allowance balance	<u>\$ 18,821</u>	<u>\$ 5,642</u>	<u>\$ 4,387</u>	<u>\$ 324</u>	<u>\$ 29,174</u>
Loans:					
Non 310-30 individually evaluated for impairment	\$ 29,411	\$ 631	\$ 7,346	\$ 188	\$ 37,576
Non 310-30 collectively evaluated for impairment	1,491,739	437,011	721,015	27,728	2,677,493
ASC 310-30 loans	39,280	89,150	16,524	898	145,852
Total loans	<u>\$ 1,560,430</u>	<u>\$ 526,792</u>	<u>\$ 744,885</u>	<u>\$ 28,814</u>	<u>\$ 2,860,921</u>

In evaluating the loan portfolio for an appropriate ALL level, non-impaired loans that were not accounted for under ASC 310-30 were grouped into segments based on broad characteristics such as primary use and underlying collateral. Within the segments, the portfolio was further disaggregated into classes of loans with similar attributes and risk characteristics for purposes of applying loss ratios and determining applicable subjective adjustments to the ALL. The application of subjective adjustments was based upon qualitative risk factors, including economic trends and conditions, industry conditions, asset quality, loss trends, lending management, portfolio growth and loan review/internal audit results.

Net charge-offs on non 310-30 loans during 2017 were \$10.9 million. Management's evaluation of credit quality resulted in a provision for loan losses on the non 310-30 loans of \$13.1 million during 2017. During 2016, the Company had \$21.6 million of net charge-offs on non 310-30 loans, of which \$19.1 million were from the energy portfolio, and recorded a provision for loan losses on non 310-30 loans of \$24.5 million, of which \$18.9 million were from the energy portfolio.

During 2017 and 2016, the Company re-estimated the expected cash flows of the loan pools accounted for under ASC 310-30. The re-measurement in 2017 resulted in a net recoupment of \$154 thousand, due to a \$194 thousand recoupment in the non-owner occupied commercial real estate segment. The re-measurement in 2016 resulted in a net recoupment of \$805 thousand, which was comprised primarily of a \$788 thousand recoupment in the commercial segment.

## Note 8 Premises and Equipment

Premises and equipment consisted of the following at December 31, 2017 and 2016:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
Land	\$ 28,698	\$ 29,864
Buildings and improvements	73,703	69,980
Equipment	46,091	42,067
Total premises and equipment, at cost	<u>148,492</u>	<u>141,911</u>
Less: accumulated depreciation and amortization	<u>(54,784)</u>	<u>(46,240)</u>
Premises and equipment, net	<u>\$ 93,708</u>	<u>\$ 95,671</u>

The Company incurred \$7.6 million, \$8.7 million and \$10.1 million of depreciation expense during 2017, 2016 and 2015, respectively, as a component of occupancy and equipment expense in the consolidated statements of operations. The Company disposed of \$2.3 million, \$3.5 million and \$0.1 million of premises and equipment, net, during 2017, 2016 and 2015, respectively.

During 2017, the Company consolidated two banking centers and completed the divestiture of four banking centers, resulting in a gain of \$2.9 million included in non-interest income in the consolidated statements of operations. The divestiture included buildings classified as held-for-sale, which were adjusted to the lower of the carrying amount or fair value less cost to sell and totaled \$1.6 million at December 31, 2016.

During 2016, the Company consolidated seven banking centers resulting in certain buildings classified as held-for-sale, which were adjusted to the lower of the carrying amount or fair value less cost to sell. The adjustment totaled \$1.4 million and is included in the consolidated statements of operations at December 31, 2015.

Space in certain facilities is leased under operating leases. Below is a summary of future minimum lease payments as of December 31, 2017:

<u>Years ending December 31,</u>	<u>Amount</u>
2018	\$ 3,158
2019	3,092
2020	2,981
2021	3,091
2022	3,052
Thereafter	12,210
Total	<u>\$ 27,584</u>

## Note 9 Other Real Estate Owned

A summary of the activity in the OREO balances during 2017 and 2016 is as follows:

	<u>For the years ended December 31,</u>	
	<u>2017</u>	<u>2016</u>
Beginning balance	\$ 15,662	\$ 20,814
Transfers from loan portfolio, at fair value	1,800	6,868
Impairments	(766)	(298)
Sales, net	<u>(6,205)</u>	<u>(11,722)</u>
Ending balance	<u>\$ 10,491</u>	<u>\$ 15,662</u>

The OREO balances excluded \$0.7 million and \$1.6 million at December 31, 2017 and 2016, respectively, of the Company's minority interests in OREO, which are held by outside banks where the Company was not the lead bank and does not have a controlling interest. The Company maintains a receivable in other assets for these minority interests. Included in Sales, net are gains of \$4.2 million and \$4.4 million for the years ended December 31, 2017 and 2016, respectively.

## Note 10 Goodwill and Intangible Assets

In connection with our acquisitions, the Company recorded goodwill of \$59.6 million and core deposit intangible assets of \$38.4 million. The Company is amortizing the core deposit intangibles on a straight line basis over 7 years from the date of the respective acquisitions, which represents the expected useful life of the assets. The Company recognized core deposit intangible amortization expense of \$5.3 million, \$5.5 million and \$5.4 million during 2017, 2016 and 2015, respectively. The following table shows the estimated future amortization expense as of December 31, 2017:

<u>Years ending December 31,</u>	<u>Amount</u>
2018	\$ 1,122
2019	135
2020	135
2021	135
2022	79

The accumulated amortization of the core deposit intangible assets was \$36.8 million and \$31.5 million at December 31, 2017 and 2016, respectively. At December 31, 2017, the core deposit intangible for the Bank Midwest and Hillcrest Bank acquisitions were fully amortized.

The Company had goodwill of \$59.6 million at December 31, 2017 and 2016. The goodwill is measured as the excess of the fair value of consideration paid over the fair value of assets acquired. No goodwill impairment was recorded during 2017, 2016 or 2015.

## Note 11 Deposits

Total deposits were \$4.0 billion and \$3.9 billion at December 31, 2017 and 2016, respectively. Time deposits were \$1.1 billion and \$1.2 billion at December 31, 2017 and 2016, respectively. At December 31, 2016, deposits totaling \$103.0 million were held-for-sale, including \$51.6 million of time deposits. The following table summarizes the Company's time deposits by remaining contractual maturity:

<u>Years ending December 31,</u>	<u>Amount</u>
2018	\$ 684,622
2019	308,139
2020	100,275
2021	7,044
2022	14,389
Thereafter	3,581
Total time deposits	<u>\$ 1,118,050</u>

The Company incurred interest expense on deposits as follows during the periods indicated:

	<u>For the years ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
Interest bearing demand deposits	\$ 445	\$ 369	\$ 315
Money market accounts	4,077	3,600	3,372
Savings accounts	1,481	1,016	837
Time deposits	10,169	8,978	9,085
Total	<u>\$ 16,172</u>	<u>\$ 13,963</u>	<u>\$ 13,609</u>

The Federal Reserve System requires cash balances to be maintained at the Federal Reserve Bank based on certain deposit levels. There was no minimum reserve requirement for the Bank at December 31, 2017. The aggregate amount of certificates of deposit in denominations that meet or exceed the FDIC insurance limit was \$140.7 million and \$119.7 million at December 31, 2017 and 2016, respectively.

## Note 12 Borrowings

The following table sets forth selected information regarding repurchase agreements during 2017, 2016 and 2015:

	<u>As of and for the years ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
Maximum amount of outstanding agreements at any month end during the period	\$ 130,463	\$ 154,404	\$ 288,591
Average amount outstanding during the period	\$ 88,390	\$ 109,246	\$ 197,726
Weighted average interest rate for the period	0.19%	0.14%	0.09%

As of December 31, 2017, 2016 and 2015, the Company had pledged mortgage-backed securities with a fair value of approximately \$136.1 million, \$99.1 million and \$205.7 million, respectively, for securities sold under agreements to repurchase. Additionally, there was \$5.7 million, \$7.0 million and \$68.1 million of excess collateral pledged for repurchase agreements at December 31, 2017, 2016 and 2015, respectively.

The vast majority of the Company's repurchase agreements are overnight transactions with clients that mature the day after the transaction. During 2017, 2016 and 2015, the overnight agreements had a weighted average interest rate of 0.19%, 0.14% and 0.09%, respectively. At December 31, 2017, 2016 and 2015, none of the Company's repurchase agreements were for periods longer than one day. The repurchase agreements are subject to a master netting arrangement; however, the Company has not offset any of the amounts shown in the consolidated financial statements.

As a member of the FHLB, the Bank has access to a line of credit and term financing from the FHLB with total available credit of \$806.7 million at December 31, 2017. At December 31, 2017, 2016 and 2015, the Bank had \$129.1 million, \$25.0 million and \$25.0 million in term advances from the FHLB, respectively. All of the outstanding advances have fixed interest rates between 1.31% - 2.33%, with maturity dates of 2018 - 2020. The Bank had investment securities pledged as collateral for FHLB advances in the amount of \$28.1 million, \$28.8 million and \$41.7 million at December 31, 2017, 2016 and 2015, respectively. Interest expense related to FHLB advances totaled \$1.8 million, \$0.7 million and \$0.7 million for the years ended December 31, 2017, 2016 and 2015, respectively.

## Note 13 Regulatory Capital

As a bank holding company, the Company is subject to the regulatory capital adequacy requirements implemented by the Federal Reserve. The federal banking agencies have risk-based capital adequacy regulations intended to provide a measure of capital adequacy that reflects the degree of risk associated with a banking organization's operations. Under these regulations, assets are assigned to one of several risk categories, and nominal dollar amounts of assets and credit equivalent amounts of off-balance-sheet items are multiplied by a risk adjustment percentage for the category.

The Basel III Capital rules, effective January 1, 2015, changed the components of regulatory capital, changed the way in which risk ratings are assigned to various categories of bank assets and defined a new Tier 1 common risk-based ratio. In addition, a capital conservative buffer requirement, designed to strengthen an institution's financial resilience during economic cycles through the restriction of capital distributions and other payments, became effective in 2016, with full phase-in beginning January 1, 2019. When fully phased-in, the capital conservation buffer adds a 2.5% capital requirement above existing regulatory minimum ratios.

Under the Basel III requirements, at December 31, 2017 and 2016, the Company and the Bank met all capital requirements and the Bank had regulatory capital ratios in excess of the levels established for well-capitalized institutions, as detailed in the tables below.

	December 31, 2017					
	Actual		Required to be well capitalized under prompt corrective action provisions		Required to be considered adequately capitalized <sup>(1)</sup>	
	Ratio	Amount	Ratio	Amount	Ratio	Amount
Tier 1 leverage ratio:						
Consolidated	9.8%	\$ 470,877	N/A	N/A	4.0%	\$ 191,559
NBH Bank	8.1%	382,918	5.0%	\$ 237,772	4.0%	190,217
Common equity tier 1 risk-based capital:						
Consolidated	12.9%	\$ 470,877	N/A	N/A	7.0%	\$ 335,228
NBH Bank	10.6%	382,918	6.5%	\$ 309,103	7.0%	332,881
Tier 1 risk-based capital ratio:						
Consolidated	12.9%	\$ 470,877	N/A	N/A	8.5%	\$ 309,400
NBH Bank	10.6%	382,918	8.0%	\$ 289,022	8.5%	307,086
Total risk-based capital ratio:						
Consolidated	13.8%	\$ 502,917	N/A	N/A	10.5%	\$ 382,200
NBH Bank	11.5%	414,958	10.0%	\$ 361,277	10.5%	379,341

	December 31, 2016					
	Actual		Required to be well capitalized under prompt corrective action provisions		Required to be considered adequately capitalized <sup>(1)</sup>	
	Ratio	Amount	Ratio	Amount	Ratio	Amount
Tier 1 leverage ratio:						
Consolidated	10.4%	\$ 470,259	N/A	N/A	4.0%	\$ 181,019
NBH Bank	8.6%	389,189	4.5%	\$ 202,903	4.0%	180,358
Common equity tier 1 risk-based capital:						
Consolidated	14.2%	\$ 470,259	N/A	N/A	7.0%	\$ 316,784
NBH Bank	11.8%	389,189	6.5%	\$ 293,082	7.0%	315,627
Tier 1 risk-based capital ratio:						
Consolidated	14.2%	\$ 470,259	N/A	N/A	8.5%	\$ 282,578
NBH Bank	11.8%	389,189	8.0%	\$ 264,596	8.5%	281,133
Total risk-based capital ratio:						
Consolidated	15.0%	\$ 499,759	N/A	N/A	10.5%	\$ 349,067
NBH Bank	12.7%	418,689	10.0%	\$ 330,745	10.5%	347,282

(1) As of the fully phased-in date of January 1, 2019, including the capital conservation buffer.

#### Note 14 FDIC Loss-Sharing Related

During the fourth quarter of 2015, the Bank entered into an early termination agreement with the FDIC, terminating its loss-share agreements. The Bank paid consideration of \$15.1 million to the FDIC for the termination of the agreements. Additionally, the Bank recorded a pre-tax gain of \$4.9 million in the fourth quarter of 2015, which was recorded in FDIC loss-sharing related income in the consolidated statements of operations. FDIC related income during 2015 was \$(15.6) million, mostly driven by FDIC indemnification asset amortization.

#### Note 15 Stock-based Compensation and Benefits

The Company provides stock-based compensation in accordance with shareholder-approved plans. During the second quarter of 2014, shareholders approved the 2014 Omnibus Incentive Plan (the "2014 Plan"). The 2014 Plan replaces the NBH Holdings Corp. 2009 Equity Incentive Plan (the "Prior Plan"), pursuant to which the Company granted equity awards prior to the approval of the 2014 Plan. Pursuant to the 2014 Plan, the Compensation Committee of the Board of Directors has the

authority to grant, from time to time, awards of stock options, stock appreciation rights, restricted stock, restricted stock units, performance units, other stock-based awards, or any combination thereof to eligible persons.

As of December 31, 2017, the aggregate number of Class A common stock available for issuance under the 2014 Plan is 5,754,830 shares. Any shares that are subject to stock options or stock appreciation rights under the 2014 Plan will be counted against the amount available for issuance as one share for every one share granted, and any shares that are subject to awards under the 2014 Plan other than stock options or stock appreciation rights will be counted against the amount available for issuance as 3.25 shares for every one share granted. The 2014 Plan provides for recycling of shares from both the Prior Plan and the 2014 Plan, the terms of which are further described in the Company's Proxy Statement for its 2014 Annual Meeting of Shareholders. Upon an option exercise, it is the Company's policy to issue shares from treasury stock.

To date, the Company has issued stock options, restricted stock and performance stock units under the plans. The Compensation Committee sets the option exercise price at the time of grant, but in no case is the exercise price less than the fair market value of a share of stock at the date of grant.

### *Stock options*

The Company issued stock options during 2017, 2016 and 2015, which are primarily time-vesting with 1/3 vesting on each of the first, second and third anniversary of the date of grant or date of hire.

The expense associated with the awarded stock options was measured at fair value using a Black-Scholes option-pricing model. The outstanding option awards vest on a graded basis over 1-4 years of continuous service and have 7-10 year contractual terms.

Below are the weighted average assumptions used in the Black-Scholes option pricing model to determine fair value of the Company's stock options granted in 2017, 2016 and 2015:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Weighted average fair value	\$ 7.84	\$ 4.24	\$ 4.37
Weighted average risk-free interest rate <sup>(1)</sup>	2.14%	1.47%	1.59%
Expected volatility <sup>(2)</sup>	21.61%	22.47%	23.87%
Expected term (years) <sup>(3)</sup>	6.09	6.09	6.01
Dividend yield <sup>(4)</sup>	0.83%	1.02%	1.05%

- (1) The risk-free rate for the expected term of the options was based on the U.S. Treasury yield curve at the date of grant and based on the expected term.
- (2) Expected volatility was calculated using a time-based weighted migration of the Company's own stock price volatility coupled with those of a peer group of eight comparable publicly traded companies for a period commensurate with the expected term of the options.
- (3) The expected term was estimated to be the average of the contractual vesting term and time to expiration.
- (4) The dividend yield was assumed to be \$0.05 per share per quarter through the third quarter of 2016, \$0.07 per share per quarter through the first quarter of 2017 and \$0.09 per share per quarter through the fourth quarter of 2017 in accordance with the Company's dividend policy at the time of grant.

The Company issued stock options in accordance with the 2014 Plan during 2017. The following table summarizes stock option activity for 2017:

	Options	Weighted average exercise price	Weighted average remaining contractual term in years	Aggregate intrinsic value
Outstanding at December 31, 2016	2,185,922	\$ 19.81	4.85	\$ 7,753
Granted	100,401	33.98		
Exercised	(658,371)	19.91		
Forfeited	(29,634)	19.82		
Outstanding at December 31, 2017	1,598,318	\$ 20.62	4.07	\$ 19,017
Options exercisable at December 31, 2017	1,372,300	\$ 19.82	3.35	\$ 17,306
Options vested and expected to vest	1,581,184	\$ 20.54	4.02	\$ 18,924

Stock option expense is a component of salaries and benefits in the consolidated statements of operations and totaled \$0.7 million, \$0.7 million and \$0.7 million for 2017, 2016 and 2015, respectively. At December 31, 2017, there was \$0.5 million of total unrecognized compensation cost related to non-vested stock options granted under the plans. The cost is expected to be recognized over a weighted average period of 2.0 years.

The following table summarizes the Company's outstanding stock options:

Range of exercise price	Options outstanding			Options exercisable	
	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable	Weighted average exercise price
\$ 18.00 - 18.99	129,327	5.85	\$ 18.55	129,145	\$ 18.55
\$ 19.00 - 19.99	243,649	7.78	\$ 19.38	115,278	\$ 19.31
\$ 20.00 - 20.99	1,126,549	2.61	\$ 20.01	1,125,577	\$ 20.01
\$ 21.00 and above	98,793	9.14	\$ 33.42	2,300	\$ 23.98

#### *Restricted stock awards*

The Company issued time based restricted stock awards during 2017, 2016 and 2015. The restricted stock awards vest over a range of a 1 – 3 year period. Restricted stock with time-based vesting was valued at the fair value of the shares on the date of grant as they are assumed to be held beyond the vesting period.

No market-based stock awards were granted during 2017. During the year ended December 31, 2016, the Company granted market-based awards of 26,594 shares in accordance with the 2014 Plan. These shares have a five-year performance period and vest upon the later of the Company's stock price achieving an established price goal during the performance period and the third anniversary of the date of grant. The \$11.28 per share fair value of these awards was determined using a Monte Carlo Simulation at grant date. The market-based performance condition had been met for these awards and the total unrecognized compensation cost related to these non-vested awards totaled \$0.1 million, and is expected to be recognized over a weighted average period of approximately 1.2 years.

#### *Performance stock units*

During the year ended December 31, 2017 and 2016, the Company granted 49,758 and 91,342 performance stock units in accordance with the 2014 Plan, respectively. These performance stock units granted represent initial target awards and do not reflect potential increases or decreases resulting from the final performance results, which are to be determined at the end of the three-year performance period (vesting date). The actual number of shares to be awarded at the end of the performance period will range from 0% - 150% of the initial target awards. 60% of the award is based on the Company's cumulative earnings per share (EPS target) during the performance period, and 40% of the award is based on the Company's cumulative total shareholder return (TSR target), or TSR, during the performance period. On the vesting date, the Company's TSR will



be compared to the respective TSRs of the companies comprising the KBW Regional Index at the grant date to determine the shares awarded. The fair value of the EPS target portion of the award was determined based on the closing stock price of the Company's common stock on the grant date. The fair value of the TSR target portion of the award was determined using a Monte Carlo Simulation at the grant date. The weighted-average grant date fair value per unit for awards granted during 2017 of the EPS target portion and the TSR target portion was \$34.04 and \$32.06, respectively.

The following table summarizes restricted stock and performance stock unit activity during 2017 and 2016:

	<u>Restricted stock shares</u>	<u>Weighted average grant- date fair value</u>	<u>Performance stock units</u>	<u>Weighted average grant- date fair value</u>
Unvested at December 31, 2015	836,031	\$ 15.42	—	\$ —
Granted	122,992	19.15	91,342	18.22
Vested	(431,155)	15.78	—	—
Forfeited	<u>(28,597)</u>	<u>18.95</u>	<u>(6,047)</u>	<u>18.22</u>
Unvested at December 31, 2016	499,271	15.82	85,295	18.22
Granted	66,471	33.43	49,758	33.22
Vested	(380,956)	15.40	—	—
Forfeited	<u>(21,229)</u>	<u>18.73</u>	<u>(9,971)</u>	<u>21.78</u>
Unvested at December 31, 2017	<u>163,557</u>	<u>\$ 22.60</u>	<u>125,082</u>	<u>\$ 23.90</u>

As of December 31, 2017, the total unrecognized compensation cost related to the non-vested restricted stock awards and performance stock units totaled \$1.5 million and \$1.6 million, respectively, and is expected to be recognized over a weighted average period of approximately 1.8 years and 1.8 years, respectively. Expense related to non-vested restricted stock awards totaled \$2.2 million, \$2.4 million and \$2.6 million during 2017, 2016 and 2015, respectively. Expense related to non-vested performance stock units totaled \$0.8 million, \$0.4 million and \$0.0 million during 2017, 2016 and 2015, respectively. Expense related to non-vested restricted stock awards and units is a component of salaries and benefits in the Company's consolidated statements of operations.

#### *Employee Stock Purchase Plan*

The 2014 Employee Stock Purchase Plan ("ESPP") is intended to be a qualified plan within the meaning of Section 423 of the Internal Revenue Code of 1986 and allows eligible employees to purchase shares of common stock through payroll deductions up to a limit of \$25,000 per calendar year and 2,000 shares per offering period. The price an employee pays for shares is 90.0% of the fair market value of Company common stock on the last day of the offering period. The offering periods are the six-month periods commencing on March 1 and September 1 of each year and ending on August 31 and February 28 (or February 29 in the case of a leap year) of each year. There are no vesting or other restrictions on the stock purchased by employees under the ESPP. Under the ESPP, the total number of shares of common stock reserved for issuance totaled 400,000 shares, of which 355,159 were available for issuance.

Under the ESPP, employees purchased 11,178 shares and 19,178 shares during 2017 and 2016, respectively.

#### **Note 16 Warrants**

During 2017 and 2016, 250,750 and 475,000 warrants were exercised in a non-cash transaction, respectively, representing the remaining outstanding warrants. The warrants were granted to certain lead investors of the Company at the time of the Company's initial capital raise (2009-2010), all with an exercise price of \$20.00 per share. Refer to the consolidated statements of changes in shareholders' equity for additional detail.

During 2015, the Company modified its remaining warrant agreements resulting in the reclassification of \$3.1 million to additional paid-in capital included in the consolidated statements of financial condition at December 31, 2015. Refer to the consolidated statements of changes in shareholders' equity for additional detail.

## Note 17 Common Stock

The Company had 26,875,585 and 26,386,583 shares of Class A common stock outstanding at December 31, 2017 and 2016, respectively. Additionally, the Company had 163,557 and 499,271 shares outstanding at December 31, 2017 and 2016, respectively, of restricted Class A common stock issued but not yet vested under the 2014 Omnibus Incentive Plan and the Prior Plan that are not included in shares outstanding until such time that they are vested; however, these shares do have voting and certain dividend rights during the vesting period.

On August 5, 2016, the Board of Directors authorized a share repurchase program for up to \$50.0 million from time to time in either the open market or through privately negotiated transactions. The remaining authorization under this program at December 31, 2017 was \$12.6 million.

## Note 18 Income Per Share

The Company calculates income per share under the two-class method, as certain non-vested share awards contain non-forfeitable rights to dividends. As such, these awards are considered securities that participate in the earnings of the Company. Non-vested shares are discussed further in note 15.

The Company had 26,875,585 and 26,386,583 shares of Class A commons stock outstanding as of December 31, 2017 and 2016, respectively, exclusive of issued non-vested restricted shares. Certain stock options and non-vested restricted shares are potentially dilutive securities, but are not included in the calculation of diluted income per share because to do so would have been anti-dilutive for 2017, 2016 and 2015.

The following table illustrates the computation of basic and diluted income per share for 2017, 2016 and 2015:

	For the years ended December 31,		
	2017	2016	2015
Net income	\$ 14,579	\$ 23,060	\$ 4,881
Less: income allocated to participating securities	(56)	(52)	(53)
Income allocated to common shareholders	\$ 14,523	\$ 23,008	\$ 4,828
Weighted average shares outstanding for basic income per common share	26,928,763	28,313,061	34,349,996
Dilutive effect of equity awards	772,392	704,831	9,321
Dilutive effect of warrants	8,504	73,451	4,170
Weighted average shares outstanding for diluted income per common share	27,709,659	29,091,343	34,363,487
Basic income per share	\$ 0.54	\$ 0.81	\$ 0.14
Diluted income per share	\$ 0.53	\$ 0.79	\$ 0.14

The Company had 1,598,318, 2,185,922 and 2,596,251 outstanding stock options to purchase common stock at weighted average exercise prices of \$20.62, \$19.81 and \$19.84 per share at December 31, 2017, 2016 and 2015, respectively, which have time-vesting criteria, and as such, any dilution is derived only for the time frame in which the vesting criteria had been met and where the inclusion of those stock options is dilutive. Additionally, 250,750 warrants were exercised in a non-cash transaction during 2017, representing the remaining outstanding warrants to purchase shares of the Company's common stock. The warrants had an exercise price of \$20.00. The Company had 288,639, 499,271 and 836,031 unvested restricted shares and units issued as of December 31, 2017, 2016 and 2015, respectively, which have performance, market and/or time-vesting criteria, and as such, any dilution is derived only for the time frame in which the vesting criteria had been met and where the inclusion of those restricted shares and units is dilutive.

## Note 19 Income Taxes

Income tax expense attributable to income before taxes was \$21.3 million, \$2.9 million and \$3.0 million for 2017, 2016 and 2015, respectively. During the fourth quarter of 2017, the Company re-measured its deferred tax asset as a result of the enactment of "H.R.1", known as the "Tax Cuts and Jobs Act", which among other items reduces the federal corporate tax rate to 21% effective January 1, 2018. Income tax expense recorded in 2017 included an \$18.5 million non-cash one-time charge

primarily related to this re-measurement. The re-measurement was based on reasonable estimates using information that was known and available from the Tax Cuts and Jobs Act as it related to our temporary differences. As additional details and technical corrections arise related to the Tax Cuts and Jobs Act, the re-measurement estimates may be subject to future adjustment.

*(a) Income taxes*

Total income taxes for 2017, 2016 and 2015 were allocated as follows:

	<b>For the years ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Current expense:			
U.S. federal	\$ 1,230	\$ 1,868	\$ 3,536
State and local	169	117	311
Total current income tax expense	<u>1,399</u>	<u>1,985</u>	<u>3,847</u>
Deferred expense (benefit):			
U.S. federal	17,639	626	(710)
State and local	2,245	336	(93)
Total deferred income tax expense (benefit)	<u>19,884</u>	<u>962</u>	<u>(803)</u>
Income tax expense	<u>\$ 21,283</u>	<u>\$ 2,947</u>	<u>\$ 3,044</u>

*(b) Tax Rate Reconciliation*

The reconciliation between the income tax expenses and the amounts computed by applying the U.S. federal income tax rate to pretax income is as follows:

	<b>For the years ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Income tax at federal statutory rate (35%)	\$ 12,550	\$ 9,103	\$ 2,774
State income taxes, net of federal benefits	265	295	142
Tax-exempt loan interest income	(5,380)	(3,798)	(2,568)
Bank-owned life insurance income	(813)	(724)	(576)
Stock-based compensation	(3,998)	(2,002)	3,520
Federal and state deferred tax rate change	18,457	—	—
Warrant valuation	—	—	37
Bargain purchase gain	—	—	(367)
Other	202	73	82
Income tax expense	<u>\$ 21,283</u>	<u>\$ 2,947</u>	<u>\$ 3,044</u>

(c) Significant Components of Deferred Taxes

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2017 and 2016 are presented below:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
Deferred tax assets:		
Excess tax basis of acquired loans over carrying value	\$ 1,887	\$ 5,865
Allowance for loan losses	7,354	11,063
Intangible assets	6,367	12,279
Other real estate owned	228	—
Accrued stock-based compensation	3,098	7,429
Accrued compensation	2,431	3,296
Capitalized start-up costs	2,488	4,554
Accrued expenses	1,227	2,218
Net deferred loan fees	622	1,198
Net operating loss	1,027	2,177
Federal tax credits	5,891	1,888
Net unrealized losses on investment securities	2,307	1,082
Other	993	1,526
Total deferred tax assets	<u>35,920</u>	<u>54,575</u>
Deferred tax liabilities:		
Premises and equipment	(113)	(937)
Other real estate owned	—	(426)
Prepaid expenses	(177)	(402)
Total deferred tax liabilities	<u>(290)</u>	<u>(1,765)</u>
Net deferred tax asset	<u>\$ 35,630</u>	<u>\$ 52,810</u>

At December 31, 2017, the Company has federal and state net operating loss carryovers (NOLs) of \$4.0 million and \$8.9 million, respectively, which are available to offset future taxable income. The federal NOLs expire in varying amounts through 2037, and the state NOLs expire in varying amounts between 2026 and 2037. The Company also has a minimum tax credit carryover of \$5.9 million that under the recently enacted tax law, the minimum tax credit is available to reduce income tax obligations in future periods without limitation and eventually becomes refundable regardless of the Company's tax liability. The minimum tax credit is available to reduce income tax obligations in future periods to the extent they exceed the calculated alternative minimum tax. The Company does not expect any tax attribute carryovers to expire before they are utilized.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, if any (including the impact of available carryforward periods), projected future taxable income, and tax-planning strategies in making this assessment. For the years ended December 31, 2017 and 2016, management believes a valuation allowance on the deferred tax asset is not necessary based on the current and future projected earnings of the Company. The Company has no ASC 740-10 unrecognized tax benefits recorded as of December 31, 2017 and 2016 and does not expect the total amount of unrecognized tax benefits to significantly increase within the next 12 months. The Company and its subsidiary bank are subject to income tax by federal, state and local government taxing authorities. The Company's tax returns for the years ended December 31, 2014 through 2017 remain subject to examination for U.S. federal income tax authorities. The years open to examination by state and local government authorities vary by jurisdiction.

The Company has unvested stock-based compensation awards outstanding at December 31, 2017, including stock options, restricted stock and performance stock units. The strike prices for options range from \$18.09 to \$34.16, with a large portion of the awards having strike prices of \$20.00. The restricted stock vest over a range of 1-3 year period. The performance stock units cliff vest over a range of 2-3 years and the number of shares issued is determined by the final performance results.

Depending on the movement in our stock price, these stock-based compensation awards may create either an excess tax benefit or tax deficiency depending on the relationship between the fair value at the time of vesting or exercise and the estimated fair value recorded at the time of grant. During 2017 and 2016, the Company recorded \$4.2 million and \$2.1 million, respectively, of excess tax benefit related to the settlement of awards during the period as a component of income tax expense in the consolidated statements of operations. During 2015, the Company recorded a tax deficiency of \$3.7 million in income tax expense resulting from expired or exercised awards. As of December 31, 2017, the Company had a \$3.1 million deferred tax asset related to stock-based compensation, \$2.3 million of which is associated with executive officers still employed by the Company.

## Note 20 Derivatives

### *Risk management objective of using derivatives*

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company has established policies that neither carrying value nor fair value at risk should exceed established guidelines. The Company has designed strategies to confine these risks within the established limits and identify appropriate trade-offs in the financial structure of its balance sheet. These strategies include the use of derivative financial instruments to help achieve the desired balance sheet repricing structure while meeting the desired objectives of its clients. Currently the Company employs certain interest rate swaps that are designated as fair value hedges as well as economic hedges. The Company manages a matched book with respect to its derivative instruments in order to minimize its net risk exposure resulting from such transactions.

### *Fair values of derivative instruments on the balance sheet*

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the consolidated statements of financial condition as of December 31, 2017 and 2016.

Information about the valuation methods used to measure fair value is provided in note 22.

	Balance Sheet location	Asset derivatives fair value		Balance Sheet location	Liability derivatives fair value	
		December 31, 2017	December 31, 2016		December 31, 2017	December 31, 2016
Derivatives designated as hedging instruments:						
Interest rate products	Other assets	\$ 10,489	\$ 9,528	Other liabilities	\$ 1,167	\$ 1,381
Total derivatives designated as hedging instruments		<u>\$ 10,489</u>	<u>\$ 9,528</u>		<u>\$ 1,167</u>	<u>\$ 1,381</u>
Derivatives not designated as hedging instruments:						
Interest rate products	Other assets	\$ 2,483	\$ 1,900	Other liabilities	\$ 2,584	\$ 1,898
Interest rate lock commitments	Other assets	128	149	Other liabilities	—	6
Forward contracts	Other assets	5	138	Other liabilities	7	20
Total derivatives not designated as hedging instruments		<u>\$ 2,616</u>	<u>\$ 2,187</u>		<u>\$ 2,591</u>	<u>\$ 1,924</u>

### *Fair value hedges*

Interest rate swaps designated as fair value hedges involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without the exchange of the underlying notional amount. As of December 31, 2017, the Company had 61 interest rate swaps with a notional amount of \$417.7 million that were designated as fair value hedges of interest rate risk associated with the Company's fixed-rate loans. The Company had 42 outstanding interest rate swaps with a notional amount of \$313.0 million that were designated as fair value hedges as of December 31, 2016.

For derivatives designated and that qualify as fair value hedges, the gain or loss on the derivative as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in earnings. The Company includes the gain or loss

on the hedged items in the same line item as the offsetting loss or gain on the related derivatives. During 2017, the Company recognized a net loss of \$995 thousand in non-interest income related to hedge ineffectiveness. During 2016, the Company recognized a net gain of \$293 thousand in non-interest income related to hedge ineffectiveness.

*Non-designated hedges*

Derivatives not designated as hedges are not speculative and consist of interest rate swaps with commercial banking clients that facilitate their respective risk management strategies. Interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions. As the interest rate swaps associated with this program do not meet the strict hedge accounting requirements, changes in the fair value of both the client swaps and the offsetting swaps are recognized directly in earnings. As of December 31, 2017, the Company had 44 matched interest rate swap transactions with an aggregate notional amount of \$202.2 million related to this program. As of December 31, 2016, the Company had 36 matched interest rate swap transactions with an aggregate notional amount of \$132.6 million related to this program.

As part of its mortgage banking activities, the Company enters into interest rate lock commitments, which are commitments to originate loans where the interest rate on the loan is determined prior to funding and the customers have locked into that interest rate. The Company then locks in the loan and interest rate with an investor and commits to deliver the loan if settlement occurs ("best efforts") or commits to deliver the locked loan in a binding ("mandatory") delivery program with an investor. Fair value changes of certain loans under interest rate lock commitments are hedged with forward sales contracts of MBS. Forward sales contracts of MBS are recorded at fair value with changes in fair value recorded in non-interest income. Interest rate lock commitments and commitments to deliver loans to investors are considered derivatives. The market value of interest rate lock commitments and best efforts contracts are not readily ascertainable with precision because they are not actively traded in stand-alone markets. The Company determines the fair value of interest rate lock commitments and delivery contracts by measuring the fair value of the underlying asset, which is impacted by current interest rates, taking into consideration the probability that the interest rate lock commitments will close or will be funded.

Certain additional risks arise from these forward delivery contracts in that the counterparties to the contracts may not be able to meet the terms of the contracts. The Company does not expect any counterparty to any MBS contract to fail to meet its obligation. Additional risks inherent in mandatory delivery programs include the risk that, if the Company fails to deliver the loans subject to interest rate risk lock commitments, it will still be obligated to "pair off" MBS to the counterparty. Should this be required, the Company could incur significant costs in acquiring replacement loans and such costs could have an adverse effect on the consolidated financial statements.

The fair value of the mortgage banking derivative is recorded as a freestanding asset or liability with the change in value being recognized in current earnings during the period of change.

The Company had 31 interest rate lock commitments with a notional value of \$8.0 million and six forward contracts with a notional value of \$9.0 million at December 31, 2017. The Company had 78 interest rate lock commitments with a notional value of \$13.8 million and 11 forward contracts with a notional value of \$11.8 million at December 31, 2016.

*Effect of derivative instruments on the consolidated statements of operations*

The tables below present the effect of the Company's derivative financial instruments in the consolidated statements of operations for 2017 and 2016:

<b>Derivatives in fair value hedging relationships</b>	<b>Location of gain (loss) recognized in income on derivatives</b>	<b>Amount of gain or (loss) recognized in income on derivatives</b>	
		<b>For the years ended December 31,</b>	
		<b>2017</b>	<b>2016</b>
Interest rate products	Other non-interest income	\$ 1,177	\$ 8,183
Total		\$ 1,177	\$ 8,183

<u>Hedged items</u>	<u>Location of gain (loss) recognized in income on hedged items</u>	<u>Amount of gain or (loss) recognized in income on hedged items</u>	
		<u>For the years ended December 31,</u>	
		<u>2017</u>	<u>2016</u>
Interest rate products	Other non-interest income	\$ (2,172)	\$ (7,890)
Total		\$ (2,172)	\$ (7,890)

<u>Derivatives not designated as hedging instruments</u>	<u>Location of gain (loss) recognized in income on derivatives</u>	<u>Amount of gain or (loss) recognized in income on derivatives</u>	
		<u>For the years ended December 31,</u>	
		<u>2017</u>	<u>2016</u>
Interest rate products	Other non-interest expense	\$ 104	\$ 129
Interest rate lock commitments	Gain on sale of mortgages, net	(13)	142
Forward contracts	Gain on sale of mortgages, net	(120)	118
Total		\$ (29)	\$ 389

### *Credit-risk-related contingent features*

The Company has agreements with its derivative counterparties that contain a provision where if the Company defaults on any of its indebtedness for reasons other than an error or omission of an administrative or operational nature, including default where repayment of the indebtedness has not been accelerated by the lender, then the Company could also be declared in default on its derivative obligations.

The Company also has agreements with certain of its derivative counterparties that contain a provision where if the Company fails to maintain its status as a well/adequately capitalized institution, then the counterparty has the right to terminate the derivative positions and the Company would be required to settle its obligations under the agreements.

As of December 31, 2017, the termination value of derivatives in a net liability position related to these agreements was \$0.5 million, which includes accrued interest but excludes any adjustment for nonperformance risk. The Company has minimum collateral posting thresholds with certain of its derivative counterparties and as of December 31, 2017, the Company had posted \$0.5 million in eligible collateral. If the Company had breached any of these provisions at December 31, 2017, it could have been required to settle its obligations under the agreements at the termination value.

### **Note 21 Commitments and Contingencies**

In the normal course of business, the Company enters into various off-balance sheet commitments to help meet the financing needs of clients. These financial instruments include commitments to extend credit, commercial and consumer lines of credit and standby letters of credit. The same credit policies are applied to these commitments as the loans on the consolidated statements of financial condition; however, these commitments involve varying degrees of credit risk in excess of the amount recognized in the consolidated statements of financial condition. At December 31, 2017 and 2016, the Company had loan commitments totaling \$680.8 million and \$602.2 million, respectively, and standby letters of credit that totaled \$7.2 million and \$13.5 million, respectively. The total amounts of unused commitments do not necessarily represent future credit exposure or cash requirements, as commitments often expire without being drawn upon. However, the contractual amount of these commitments, offset by any additional collateral pledged, represents the Company's potential credit loss exposure.

Total unfunded commitments at December 31, 2017 and 2016 were as follows:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
Commitments to fund loans	\$ 181,904	\$ 149,391
Unfunded commitments under lines of credit	498,857	452,851
Commercial and standby letters of credit	7,185	13,532
Total unfunded commitments	\$ 687,946	\$ 615,774

*Commitments to fund loans*—Commitments to fund loans are legally binding agreements to lend to clients in accordance with predetermined contractual provisions providing there have been no violations of any conditions specified in the contract. These commitments are generally at variable interest rates and are for specific periods or contain termination clauses and may require the payment of a fee. The total amounts of unused commitments are not necessarily representative of future credit exposure or cash requirements, as commitments often expire without being drawn upon.

*Unfunded commitments under lines of credit*—In the ordinary course of business, the Company extends revolving credit to its clients. These arrangements may require the payment of a fee.

*Commercial and standby letters of credit*—As a provider of financial services, the Company routinely issues commercial and standby letters of credit, which may be financial standby letters of credit or performance standby letters of credit. These are various forms of “back-up” commitments to guarantee the performance of a client to a third party. While these arrangements represent a potential cash outlay for the Company, the majority of these letters of credit will expire without being drawn upon. Letters of credit are subject to the same underwriting and credit approval process as traditional loans, and as such, many of them have various forms of collateral securing the commitment, which may include real estate, personal property, receivables or marketable securities.

### ***Contingencies***

In the ordinary course of business, the Company and the Bank may be subject to litigation. Based upon the available information and advice from the Company’s legal counsel, management does not believe that any potential, threatened or pending litigation to which it is a party will have a material adverse effect on the Company’s liquidity, financial condition or results of operations.

### **Note 22 Fair Value Measurements**

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to disclose the fair value of its financial instruments. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. For disclosure purposes, the Company groups its financial and non-financial assets and liabilities into three different levels based on the nature of the instrument and the availability and reliability of the information that is used to determine fair value. The three levels are defined as follows:

- Level 1—Includes assets or liabilities in which the inputs to the valuation methodologies are based on unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2—Includes assets or liabilities in which the inputs to the valuation methodologies are based on similar assets or liabilities in inactive markets, quoted prices for identical or similar assets or liabilities in inactive markets, and inputs other than quoted prices that are observable, such as interest rates, yield curves, volatilities, prepayment speeds, and other inputs obtained from observable market input.
- Level 3—Includes assets or liabilities in which the inputs to the valuation methodology are based on at least one significant assumption that is not observable in the marketplace. These valuations may rely on management’s judgment and may include internally-developed model-based valuation techniques.

Level 1 inputs are considered to be the most transparent and reliable and level 3 inputs are considered to be the least transparent and reliable. The Company assumes the use of the principal market to conduct a transaction of each particular asset or liability being measured and then considers the assumptions that market participants would use when pricing the asset or liability. Whenever possible, the Company first looks for quoted prices for identical assets or liabilities in active markets (level 1 inputs) to value each asset or liability. However, when inputs from identical assets or liabilities on active markets are not available, the Company utilizes market observable data for similar assets and liabilities. The Company maximizes the use of observable inputs and limits the use of unobservable inputs to occasions when observable inputs are not available. The need to use unobservable inputs generally results from the lack of market liquidity of the actual financial instrument or of the underlying collateral. Although, in some instances, third party price indications may be available, limited trading activity can challenge the observability of these quotations.

Changes in the valuation inputs used for measuring the fair value of financial instruments may occur due to changes in current market conditions or other factors. Such changes may necessitate a transfer of the financial instruments to another level in the hierarchy based on the new inputs used. The Company recognizes these transfers at the end of the reporting



period that the transfer occurs. During 2017 and 2016, there were no transfers of financial instruments between the hierarchy levels.

The following is a description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of each instrument under the valuation hierarchy:

#### ***Fair Value of Financial Instruments Measured on a Recurring Basis***

*Investment securities available-for-sale*—Investment securities available-for-sale are carried at fair value on a recurring basis. To the extent possible, observable quoted prices in an active market are used to determine fair value and, as such, these securities are classified as level 1. At December 31, 2017 and 2016, the Company did not hold any level 1 securities. When quoted market prices in active markets for identical assets or liabilities are not available, quoted prices of securities with similar characteristics, discounted cash flows or other pricing characteristics are used to estimate fair values and the securities are then classified as level 2.

*Loans held for sale*—The Company has elected to record loans originated and intended for sale in the secondary market at estimated fair value. The Company estimates fair value based on quoted market prices for similar loans in the secondary market and is classified as level 2.

*Interest rate swap derivatives*—The Company's derivative instruments are limited to interest rate swaps that may be accounted for as fair value hedges or non-designated hedges. The fair values of the swaps incorporate credit valuation adjustments in order to appropriately reflect nonperformance risk in the fair value measurements. The credit valuation adjustment is the dollar amount of the fair value adjustment related to credit risk and utilizes a probability weighted calculation to quantify the potential loss over the life of the trade. The credit valuation adjustments are calculated by determining the total expected exposure of the derivatives (which incorporates both the current and potential future exposure) and then applying the respective counterparties' credit spreads to the exposure offset by marketable collateral posted, if any. Certain derivative transactions are executed with counterparties who are large financial institutions ("dealers"). International Swaps and Derivative Association Master Agreements ("ISDA") and Credit Support Annexes ("CSA") are employed for all contracts with dealers. These contracts contain bilateral collateral arrangements. The fair value inputs of these financial instruments are determined using discounted cash flow analysis through the use of third-party models whose significant inputs are readily observable market parameters, primarily yield curves, with appropriate adjustments for liquidity and credit risk, and are classified as level 2.

*Mortgage banking derivatives*—The Company relies on a third-party pricing service to value its mortgage banking derivative financial assets and liabilities, which the Company classifies as a level 3 valuation. The external valuation model to estimate the fair value of its interest rate lock commitments to originate residential mortgage loans held for sale includes grouping the interest rate lock commitments by interest rate and terms, applying an estimated pull-through rate based on historical experience, and then multiplying by quoted investor prices determined to be reasonably applicable to the loan commitment groups based on interest rate, terms, and rate lock expiration dates of the loan commitment groups. The Company also relies on an external valuation model to estimate the fair value of its forward commitments to sell residential mortgage loans (i.e., an estimate of what the Company would receive or pay to terminate the forward delivery contract based on market prices for similar financial instruments), which includes matching specific terms and maturities of the forward commitments against applicable investor pricing.

The tables below present the financial instruments measured at fair value on a recurring basis as of December 31, 2017 and 2016, on the consolidated statements of financial condition utilizing the hierarchy structure described above:

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
Investment securities available-for-sale:				
Mortgage-backed securities (“MBS”):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	\$ —	\$ 168,648	\$ —	\$ 168,648
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	—	685,230	—	685,230
Municipal securities	—	829	—	829
Loans held for sale	—	4,629	—	4,629
Interest rate swap derivatives	—	12,972	—	12,972
Mortgage banking derivatives	—	—	133	133
Total assets at fair value	<u>\$ —</u>	<u>\$ 872,308</u>	<u>\$ 133</u>	<u>\$ 872,441</u>
<b>Liabilities:</b>				
Interest rate swap derivatives	\$ —	\$ 3,751	\$ —	\$ 3,751
Mortgage banking derivatives	—	—	7	7
Total liabilities at fair value	<u>\$ —</u>	<u>\$ 3,751</u>	<u>\$ 7</u>	<u>\$ 3,758</u>

	December 31, 2016			
	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
Investment securities available-for-sale:				
Mortgage-backed securities (“MBS”):				
Residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises	\$ —	\$ 227,160	\$ —	\$ 227,160
Other residential MBS issued or guaranteed by U.S. Government agencies or sponsored enterprises	—	652,739	—	652,739
Municipal securities	—	3,648	—	3,648
Loans held for sale	—	24,187	—	24,187
Interest rate swap derivatives	—	11,428	—	11,428
Mortgage banking derivatives	—	—	287	287
Total assets at fair value	<u>\$ —</u>	<u>\$ 919,162</u>	<u>\$ 287</u>	<u>\$ 919,449</u>
<b>Liabilities:</b>				
Interest rate swap derivatives	\$ —	\$ 3,279	\$ —	\$ 3,279
Mortgage banking derivatives	—	—	26	26
Total liabilities at fair value	<u>\$ —</u>	<u>\$ 3,279</u>	<u>\$ 26</u>	<u>\$ 3,305</u>

The table below details the changes in level 3 financial instruments during 2017:

	Mortgage banking derivatives, net
Balance at December 31, 2016	\$ 261
Loss included in earnings, net	(135)
Net change in Level 3	(135)
Balance at December 31, 2017	<u>\$ 126</u>

### ***Fair Value of Financial Instruments Measured on a Non-recurring Basis***

Certain assets may be recorded at fair value on a non-recurring basis as conditions warrant. These non-recurring fair value measurements typically result from the application of lower of cost or fair value accounting or a write-down occurring during the period.

The Company records collateral dependent loans that are considered to be impaired at their estimated fair value. A loan is considered impaired when it is probable that the Company will be unable to collect all contractual amounts due in accordance with the terms of the loan agreement. Collateral dependent impaired loans are measured based on the fair value of the collateral. The Company relies on third-party appraisals and internal assessments, utilizing a discount rate in the range of 0% - 25%, in determining the estimated fair values of these loans. The inputs used to determine the fair values of loans are considered level 3 inputs in the fair value hierarchy. At December 31, 2017, the Company measured seven loans not accounted for under ASC 310-30 at fair value on a non-recurring basis with a carrying balance of \$7.1 million and specific reserve balance of \$1.5 million. At December 31, 2016, the Company measured three loans not accounted for under ASC 310-30 at fair value on a non-recurring basis with a carrying balance of \$10.5 million and a specific reserve balance of \$2.4 million.

OREO is recorded at the lower of the cost basis or the fair value of the collateral less estimated selling costs. The estimated fair values of OREO are updated periodically and further write-downs may be taken to reflect a new basis. The Company recognized \$0.8 million and \$0.3 million of OREO impairments in its consolidated statements of operations during 2017 and 2016, respectively. The fair values of OREO are derived from third party price opinions or appraisals that generally use an income approach or a market value approach. If reasonable comparable appraisals are not available, then the Company may use internally developed models to determine fair values. The inputs used to determine the fair values of OREO are considered level 3 inputs in the fair value hierarchy.

The Company may be required to record fair value adjustments on other available-for-sale and municipal securities valued at par on a non-recurring basis.

The tables below provide information regarding the assets recorded at fair value on a non-recurring basis at December 31, 2017 and 2016:

	<u>December 31, 2017</u>	
	<u>Total</u>	<u>Losses from fair value changes</u>
Other real estate owned	\$ 10,491	\$ 766
Impaired loans	30,873	11,099

	<u>December 31, 2016</u>	
	<u>Total</u>	<u>Losses from fair value changes</u>
Other real estate owned	\$ 15,662	\$ 154
Impaired loans	38,282	15,200

The Company did not record any liabilities measured at fair value on a non-recurring basis during 2017 and 2016.

### **Note 23 Fair Value of Financial Instruments**

The fair value of a financial instrument is the amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is determined based upon quoted market prices to the extent possible; however, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques that may be significantly impacted by the assumptions used, including the discount rate and estimates of future cash flows. Changes in any of these assumptions could significantly affect the fair value estimates. The fair value of the financial instruments listed below does not reflect a premium or discount that could result from offering all of the Company's holdings of financial instruments at one time, nor does it reflect the underlying value of the Company, as ASC Topic 825 excludes certain financial instruments and all non-financial instruments from its disclosure requirements.

The fair value of financial instruments at December 31, 2017 and 2016, including methods and assumptions utilized for determining fair value of financial instruments, are set forth below:

	Level in fair value measurement hierarchy	December 31, 2017		December 31, 2016	
		Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
<b>ASSETS</b>					
Cash and cash equivalents	Level 1	\$ 257,364	\$ 257,364	\$ 152,736	\$ 152,736
Mortgage-backed securities—residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises available-for-sale	Level 2	168,648	168,648	227,160	227,160
Mortgage-backed securities—other residential mortgage-backed securities issued or guaranteed by U.S. Government agencies or sponsored enterprises available-for-sale	Level 2	685,230	685,230	652,739	652,739
Municipal securities	Level 2	829	829	3,648	3,648
Municipal securities	Level 3	219	219	265	265
Other available-for-sale securities	Level 3	419	419	419	419
Mortgage-backed securities—residential mortgage pass-through securities issued or guaranteed by U.S. Government agencies or sponsored enterprises held-to-maturity	Level 2	204,352	204,048	263,411	264,862
Mortgage-backed securities—other residential mortgage-backed securities issued or guaranteed by U.S. Government agencies or sponsored enterprises held-to-maturity	Level 2	54,378	52,723	69,094	67,711
Non-marketable securities	Level 2	15,030	15,030	14,949	14,949
Loans receivable	Level 3	3,178,947	3,167,508	2,860,921	2,879,860
Loans held for sale	Level 2	4,629	4,629	24,187	24,187
Accrued interest receivable	Level 2	14,255	14,255	12,562	12,562
Interest rate swap derivatives	Level 2	12,972	12,972	11,428	11,428
Mortgage banking derivatives	Level 3	133	133	287	287
<b>LIABILITIES</b>					
Deposit transaction accounts	Level 2	2,861,509	2,861,509	2,696,603	2,696,603
Time deposits	Level 2	1,118,050	1,118,050	1,172,046	1,172,046
Securities sold under agreements to repurchase	Level 2	130,463	130,463	92,011	92,011
Federal Home Loan Bank advances	Level 2	129,115	130,300	38,665	39,324
Accrued interest payable	Level 2	5,776	5,776	4,973	4,973
Interest rate swap derivatives	Level 2	3,751	3,751	3,279	3,279
Mortgage banking derivatives	Level 3	7	7	187	187

#### *Cash and cash equivalents*

Cash and cash equivalents have a short-term nature and the estimated fair value is equal to the carrying value.

#### *Investment securities*

The estimated fair value of investment securities is based on quoted market prices or bid quotations received from securities dealers. Other investment securities, including securities that are held for regulatory purposes are carried at cost, less any other than temporary impairment.

#### *Loans receivable*

The estimated fair value of the loan portfolio is estimated using a discounted cash flow analysis using a discount rate based on interest rates offered at the respective measurement dates for loans with similar terms to borrowers of similar credit quality. The allowance for loan losses is considered a reasonable estimate of any required adjustment to fair value to reflect

the impact of credit risk. The estimates of fair value do not incorporate the exit-price concept prescribed by ASC Topic 820, *Fair Value Measurements and Disclosures*.

#### *Loans held-for-sale*

Loans held-for-sale are carried at an estimated fair value. The portfolio consists primarily of fixed rate residential mortgage loans that are sold within 45 days. The estimated fair value is based on quoted market prices for similar loans in the secondary market and is classified as level 2.

#### *Accrued interest receivable*

Accrued interest receivable is of a short-term nature and the estimated fair value is equal to the carrying value.

#### *Deposits*

The estimated fair value of deposits with no stated maturity, such as non-interest bearing demand deposits, savings, NOW accounts, and money market accounts, is equal to the amount payable on demand. The fair value of interest-bearing time deposits is based on the discounted value of contractual cash flows of such deposits, taking into account the option for early withdrawal. The discount rate is estimated using the rates offered by the Company, at the respective measurement dates, for deposits of similar remaining maturities. The fair value of time deposits has a floor equal to the carrying value as the amount payable on demand would approximate the carrying value.

#### *Derivative assets and liabilities*

Fair values for derivative assets and liabilities are fully described in note 20 of the consolidated financial statements.

#### *Securities sold under agreements to repurchase*

The vast majority of the Company's repurchase agreements are overnight transactions that mature the day after the transaction, and as a result of this short-term nature, the estimated fair value is equal to the carrying value.

#### *Accrued interest payable*

Accrued interest payable is of a short-term nature and the estimated fair value is equal to the carrying value.

### **Note 24 Subsequent Events**

On January 1, 2018, the Company completed its acquisition of Peoples, Inc., the bank holding company of Colorado-based Peoples National Bank and Kansas-based Peoples Bank. Immediately following the completion of the acquisition, Peoples National Bank and Peoples Bank merged into NBH Bank. Pursuant to the merger agreement executed in June 2017, the Company paid \$36.2 million of cash consideration and 3,398,477 shares of the Company's Class A common stock in exchange for all of the outstanding common stock of Peoples. Cash paid included \$10.0 million placed in escrow for certain potential liabilities the Company is indemnified for pursuant to the merger agreement. The cash paid is included in cash and due from banks in the Company's consolidated statements of financial condition at December 31, 2017. The transaction has a value of \$146.4 million in the aggregate, based on the Company's closing price of \$32.43 on the acquisition date. Acquisition related costs of \$2.7 million were included in the Company's consolidated statements of operations for the year ended December 31, 2017.

The Company determined that this acquisition constitutes a business combination as defined in ASC Topic 805, *Business Combinations*. Accordingly, as of the date of the acquisition, the Company recorded the assets acquired and liabilities assumed at fair value. The Company determined fair values in accordance with the guidance provided in ASC Topic 820, *Fair Value Measurements and Disclosures*. Fair value is established by discounting the expected future cash flows with a market discount rate for like maturities and risk instruments. The estimation of expected future cash flows, market conditions and other future events and actual results could differ materially. The determination of the fair values of fixed assets, loans,

OREO, core deposit intangible, mortgage servicing rights and mortgage repurchase reserve involves a high degree of judgment and complexity. The Company has made the determination of provisional fair values using the best information available at the time; however, purchase accounting is not complete and the assumptions used are subject to change and, if changed, could have a material effect on the Company's financial position and results of operations.

The table below summarizes the provisional net assets acquired (at fair value) and consideration transferred in connection with the Peoples acquisition:

Assets:		
Cash and due from banks	\$	105,173
Investment securities available-for-sale		118,553
Non-marketable securities		4,846
Loans		544,233
Loans held for sale		54,260
Other real estate owned		1,436
Premises and equipment		17,931
Core deposit intangible asset		9,839
Mortgage servicing rights		4,233
Other assets		15,740
Total assets acquired	\$	<u>876,244</u>
Liabilities:		
Total deposits		729,911
Other liabilities		55,973
Total liabilities assumed	\$	<u>785,884</u>
Identifiable net assets acquired	\$	90,360
Consideration:		
NBHC common stock paid at January 1, 2018, closing price of \$32.43	\$	110,213
Cash		36,189
Total	\$	<u>146,402</u>
Estimated goodwill created	\$	56,042

In connection with the Peoples acquisition, the Company estimates it will record \$56.0 million of goodwill, a \$9.8 million core deposit intangible asset, a \$4.2 million mortgage servicing rights intangible asset and a \$3.8 million mortgage repurchase reserve, included in other liabilities. The core deposit intangible will be amortized straight-line over ten years and the mortgage servicing rights intangible is amortized in proportion to and over the period of the estimated net servicing income.

The following unaudited pro forma information combines the historical results of Peoples and the Company. The unaudited pro forma financial information does not include the potential impacts of possible business model changes, current market conditions, revenue enhancements, expense efficiencies, or other factors. The unaudited pro forma information below reflects adjustments made to exclude acquisition-related expenses of the Company and Peoples of \$13.1 million during the year ended 2017, estimated amortization and accretion of purchase discounts and premiums of \$0.9 million and \$0.9 million and estimated amortization of acquired identifiable intangibles of \$1.1 million and \$1.1 million during the years ended December 31, 2017 and 2016, respectively. The unaudited pro forma information is theoretical in nature and not necessarily indicative of future consolidated results of operations of the Company or the consolidated results of operations which would have resulted had the Company acquired Peoples during the periods presented.

If the Peoples acquisition had been completed on January 1, 2016, unaudited pro forma total revenue for the Company would have been approximately \$263.0 million and \$268.1 million for the years ended December 31, 2017 and 2016, respectively.

Unaudited pro forma net income for the Company would have been approximately \$22.6 million and \$34.7 million, respectively, for the same periods. Unaudited pro forma basic and dilutive earnings per share for the Company would have been \$0.75 and \$0.73 for the year ended December 31, 2017, respectively, and \$1.09 and \$1.07 for the year ended December 31, 2016, respectively.

## Note 25 Parent Company Only Financial Statements

Parent company only financial information for National Bank Holdings Corporation is summarized as follows:

### Condensed Statements of Financial Condition

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 73,873	\$ 64,691
Investment in subsidiaries	444,445	455,120
Other assets	14,414	16,996
Total assets	<u>\$ 532,732</u>	<u>\$ 536,807</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Other liabilities	\$ 325	\$ 618
Total liabilities	325	618
Shareholders' equity	532,407	536,189
Total liabilities and shareholders' equity	<u>\$ 532,732</u>	<u>\$ 536,807</u>

### Condensed Statements of Operations

	<u>For the years ended December 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Income</b>			
Interest income	\$ 45	\$ 24	\$ —
Undistributed equity from subsidiaries	(11,192)	(129,956)	(74,131)
Distributions from subsidiaries	28,903	155,353	86,000
Other income	—	—	1,048
Total income	<u>17,756</u>	<u>25,421</u>	<u>12,917</u>
<b>Expenses</b>			
Salaries and benefits	3,680	3,529	3,349
Other expenses	3,587	3,578	3,597
Total expenses	<u>7,267</u>	<u>7,107</u>	<u>6,946</u>
Income before income taxes	10,489	18,314	5,971
Income tax (benefit) expense	(4,090)	(4,746)	1,090
Net income	<u>\$ 14,579</u>	<u>\$ 23,060</u>	<u>\$ 4,881</u>

## Condensed Statements of Cash Flows

	For the years ended December 31,		
	2017	2016	2015
Cash flows from operating activities:			
Net income	\$ 14,579	\$ 23,060	\$ 4,881
Undistributed equity from subsidiaries	11,192	(25,388)	(11,869)
Stock-based compensation expense	3,648	3,492	3,349
Net excess tax (benefit) deficit on stock-based compensation	(4,225)	(2,078)	3,677
Other	6,680	418	(1,042)
Net cash provided by (used in) operating activities	<u>31,874</u>	<u>(496)</u>	<u>(1,004)</u>
Cash flows from investing activities:			
Outlay for business combinations	—	—	(9,482)
Dividend payment from subsidiary equity	—	15,353	—
Return of capital from investments in subsidiaries	—	140,000	86,000
Net cash provided by investing activities	<u>—</u>	<u>155,353</u>	<u>76,518</u>
Cash flows from financing activities:			
Capital contribution	(5,000)	—	—
Issuance of stock under purchase and equity compensation plans	(8,395)	(6,201)	(952)
Proceeds from exercise of stock options	104	—	160
Settlement of warrants	—	—	(368)
Payment of dividends	(9,401)	(6,131)	(6,711)
Repurchase of shares	—	(93,573)	(175,048)
Net cash used in financing activities	<u>(22,692)</u>	<u>(105,905)</u>	<u>(182,919)</u>
Net increase (decrease) in cash and cash equivalents	9,182	48,952	(107,405)
Cash and cash equivalents at beginning of the year	64,691	15,739	123,144
Cash and cash equivalents at end of the year	<u>\$ 73,873</u>	<u>\$ 64,691</u>	<u>\$ 15,739</u>

### Note 26 Quarterly Results of Operations (unaudited)

The following is a summary of quarterly results:

	December 31, 2017				
	Fourth quarter	Third quarter	Second quarter	First quarter	Total
Interest and dividend income	\$ 41,889	\$ 42,579	\$ 41,213	\$ 38,740	\$ 164,421
Interest expense	4,976	4,681	4,440	4,018	18,115
Net interest income before provision for loan losses	36,913	37,898	36,773	34,722	146,306
Provision for loan losses	3,272	3,880	4,025	1,795	12,972
Net interest income after provision for loan losses	33,641	34,018	32,748	32,927	133,334
Non-interest income	8,883	9,551	12,075	8,696	39,205
Non-interest expense	34,028	34,605	33,439	34,605	136,677
Income before income taxes	8,496	8,964	11,384	7,018	35,862
Income tax expense (benefit)	18,615	1,733	2,175	(1,240)	21,283
Net (loss) income	<u>\$ (10,119)</u>	<u>\$ 7,231</u>	<u>\$ 9,209</u>	<u>\$ 8,258</u>	<u>\$ 14,579</u>
(Loss) income per share-basic	\$ (0.37)	\$ 0.27	\$ 0.34	\$ 0.31	\$ 0.54
(Loss) income per share-diluted	\$ (0.37)	\$ 0.26	\$ 0.33	\$ 0.30	\$ 0.53



## December 31, 2016

	Fourth quarter	Third quarter	Second quarter	First quarter	Total
Interest and dividend income	\$ 39,658	\$ 40,764	\$ 38,472	\$ 41,554	\$ 160,448
Interest expense	3,873	3,700	3,719	3,516	14,808
Net interest income before provision for loan losses	35,785	37,064	34,753	38,038	145,640
Provision for loan losses	1,282	5,293	6,457	10,619	23,651
Net interest income after provision for loan losses	34,503	31,771	28,296	27,419	121,989
Non-interest income	9,992	11,608	10,504	7,923	40,027
Non-interest expense	34,423	33,370	33,314	34,902	136,009
Income before income taxes	10,072	10,009	5,486	440	26,007
Income tax expense	81	1,695	982	189	2,947
Net income	\$ 9,991	\$ 8,314	\$ 4,504	\$ 251	\$ 23,060
Income per share-basic	\$ 0.38	\$ 0.30	\$ 0.15	\$ 0.01	\$ 0.81
Income per share-diluted	\$ 0.36	\$ 0.30	\$ 0.15	\$ 0.01	\$ 0.79

## December 31, 2015

	Fourth quarter	Third quarter	Second quarter	First quarter	Total
Interest and dividend income	\$ 43,492	\$ 42,311	\$ 42,517	\$ 43,087	\$ 171,407
Interest expense	3,563	3,629	3,662	3,608	14,462
Net interest income before provision for loan losses	39,929	38,682	38,855	39,479	156,945
Provision for loan losses	5,423	3,710	1,858	1,453	12,444
Net interest income after provision for loan losses	34,506	34,972	36,997	38,026	144,501
Non-interest income	15,419	3,761	2,747	(479)	21,448
Non-interest expense	42,230	38,677	40,393	36,724	158,024
Income (loss) before income taxes	7,695	56	(649)	823	7,925
Income tax expense (benefit)	4,355	(1,580)	692	(423)	3,044
Net income (loss)	\$ 3,340	\$ 1,636	\$ (1,341)	\$ 1,246	\$ 4,881
Income (loss) per share-basic	\$ 0.11	\$ 0.05	\$ (0.04)	\$ 0.03	\$ 0.14
Income (loss) per share-diluted	\$ 0.11	\$ 0.05	\$ (0.04)	\$ 0.03	\$ 0.14

**Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES.**

There were no changes in or disagreements with accountants on accounting and financial disclosures.

**Item 9A. CONTROLS AND PROCEDURES.**

**Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

Our management, with the participation of our principal executive officer and principal financial officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as of December 31, 2017. Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of December 31, 2017.

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

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Our management, with the participation of our principal executive officer and principal financial officer, conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2017 based on the framework in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2017. KPMG LLP, the independent registered public accounting firm that audited our consolidated financial statements included in this Annual Report on Form 10-K, has issued a report on our internal control over financial reporting as of December 31, 2017, which report is included in this Item 9A below.

**Changes in Internal Control Over Financial Reporting**

There were no changes made in the Company's internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors  
National Bank Holdings Corporation:

### *Opinion on Internal Control Over Financial Reporting*

We have audited National Bank Holdings Corporation and subsidiaries' (the Company) internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated statements of financial condition of the Company as of December 31, 2017 and 2016, the related consolidated statements of operations, comprehensive income (loss), shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2017, and the related notes (collectively, the consolidated financial statements), and our report dated February 27, 2018 expressed an unqualified opinion on those consolidated financial statements.

### *Basis for Opinion*

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the 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 audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

### *Definition and Limitations of Internal Control Over Financial Reporting*

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

**KPMG LLP**

Kansas City, Missouri  
February 27, 2018

**Item 9B. OTHER INFORMATION.**

None.

**PART III**

**Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.**

The Information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2018 Annual Meeting of Shareholders to be filed with the SEC within 120 days of our fiscal year-end.

The Company's Supplemental Code of Ethics for CEO and Senior Financial Officers, which applies to the CEO, Chief Financial Officer and Principal Accounting Officer, is available at [www.nationalbankholdings.com](http://www.nationalbankholdings.com). Amendments to, and waivers of, the code of ethics are publicly disclosed as required by applicable law, regulation or rule.

**Item 11. EXECUTIVE COMPENSATION.**

The Information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2018 Annual Meeting of Shareholders to be filed with the SEC within 120 days of our fiscal year-end.

**Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS.**

The Information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2018 Annual Meeting of Shareholders to be filed with the SEC within 120 days of our fiscal year-end.

**Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.**

The Information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2018 Annual Meeting of Shareholders to be filed with the SEC within 120 days of our fiscal year-end.

**Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.**

The Information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2018 Annual Meeting of Shareholders to be filed with the SEC within 120 days of our fiscal year-end.

## PART IV

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

(a) The following documents are filed as a part of this report:

(1) Financial Statements:

	<u>Page</u>
Consolidated Statements of Financial Condition	74
Consolidated Statements of Operations	75
Consolidated Statements of Comprehensive Income (Loss)	76
Consolidated Statements of Changes in Shareholders' Equity	77
Consolidated Statements of Cash Flows	78
Notes to Consolidated Financial Statements	79

(2) Financial Statement Schedules:

All schedules are omitted as such information is inapplicable or is included in the financial statements.

(b) The exhibits filed as part of this report and exhibits incorporated herein by reference to other documents are listed below:

<u>Exhibit No</u>	<u>Description</u>
2.1*	Agreement and Plan Merger, dated as of June 23, 2017, by and among Peoples, Inc., National Bank Holdings Corporation, the Significant Stockholders (as defined herein) and Winton A. Winter, Jr., solely in his capacity as the Holders' Representative (incorporated herein by reference to Exhibit 2.1 to our Form 8-K dated June 23, 2017 and filed on June 27, 2017)
3.1	Second Amended and Restated Certificate of Incorporation (incorporated herein by reference to Exhibit 3.1 to our Form S-1 Registration Statement (Registration No. 333-177971), filed on August 22, 2012)
3.2	Second Amended and Restated By-Laws (incorporated herein by reference to Exhibit 3.2 to our Form 10-Q, filed on November 7, 2014)
4.1	Specimen common stock certificate (incorporated herein by reference to Exhibit 4.1 to our Form S-1 Registration Statement (Registration No. 333-177971), filed on August 22, 2012)
4.2	Registration Rights Agreement, dated as of October 20, 2009, by and between NBH Holdings Corp. and FBR Capital Markets, Inc. (incorporated herein by reference to Exhibit 4.2 to our Form S-1 Registration Statement (Registration No. 333-177971), filed on November 14, 2011)
4.3	Amendment No. 1, dated as of July 20, 2011, to the Registration Rights Agreement, dated as of October 20, 2009 by and between NBH Holdings Corp. and FBR Capital Markets, Inc. (incorporated herein by reference to Exhibit 4.3 to our Form S-1 Registration Statement (Registration No. 333-177971), filed on November 14, 2011)
10.1	Form of Indemnification Agreement by and between NBH Holdings Corp. and each of its directors and executive officers (incorporated herein by reference to Exhibit 10.6 to our Form S-1 Registration Statement (Registration Statement No. 333-177971), filed on September 10, 2012)^

- 10.2 Employment Agreement, dated May 22, 2010, by and between G. Timothy Laney and NBH Holdings Corp. (incorporated herein by reference to Exhibit 10.1 to our Form S-1 Registration Statement (Registration Statement No. 333-177971), filed on September 10, 2012)^
- 10.3 First Amendment to Employment Agreement, dated November 17, 2015, by and between G. Timothy Laney and National Bank Holdings Corporation (incorporated herein by reference to Exhibit 10.2 to our Form 8-K, filed on November 20, 2015)^
- 10.4 Amended and Restated Employment Agreement, dated November 17, 2015, by and between Richard U. Newfield, Jr. and National Bank Holdings Corporation (incorporated herein by reference to Exhibit 10.4 to our Form 8-K, filed on November 20, 2015)^
- 10.5 Employment Agreement, dated November 17, 2015, by and between Brian F. Lilly and National Bank Holdings Corporation (incorporated herein by reference to Exhibit 10.3 to our Form 8-K, filed on November 20, 2015)^
- 10.6 Employment Agreement, dated November 17, 2015, by and between Zsolt K. Besskó and National Bank Holdings Corporation (incorporated herein by reference to Exhibit 10.5 to our Form 8-K, filed on November 20, 2015)^
- 10.7 National Bank Holdings Corporation Employee Stock Purchase Plan (incorporated herein by reference to Annex A to the Company's Definitive Proxy Statement on Schedule 14A, filed on March 30, 2015)^
- 10.8 NBH Holdings Corp. 2009 Equity Incentive Plan (incorporated herein by reference to Exhibit 10.2 to our Form S-1 Registration Statement (Registration No. 333-177971), filed on November 14, 2011)^
- 10.9 Amendment to the NBH Holdings Corp. 2009 Equity Incentive Plan dated February 22, 2017 (incorporated herein by reference to Exhibit 10.10 to our form 10-K, filed on February 24, 2017)^
- 10.10 National Bank Holdings Corporation 2014 Omnibus Incentive Plan (incorporated herein by reference to Annex A to the Company's Definitive Proxy Statement on Schedule 14A, filed on March 31, 2014)^
- 10.11 Form of National Bank Holdings Corporation 2014 Omnibus Incentive Plan Performance Stock Unit Award Agreement (For Management) (incorporated herein by reference to Exhibit 10.12 to our form 10-K, filed on February 24, 2017)^
- 10.12 Form of National Bank Holdings Corporation 2014 Omnibus Incentive Plan Restricted Stock Award Agreement (For Management) (incorporated herein by reference to Exhibit 10.13 to our form 10-K, filed on February 24, 2017)^
- 10.13 Form of National Bank Holdings Corporation 2014 Omnibus Incentive Plan Nonqualified Stock Option Agreement (For Management) (incorporated herein by reference to Exhibit 10.14 to our form 10-K, filed on February 24, 2017)^
- 10.14 Form of National Bank Holdings Corporation 2014 Omnibus Incentive Plan Market-Based Performance Award Agreement (For Management) (incorporated herein by reference to Exhibit 10.15 to our form 10-K, filed on February 24, 2017)^
- 10.15 Form of National Bank Holdings Corporation 2014 Omnibus Incentive Plan Restricted Stock Award Agreement (For Non-Employee Directors) (incorporated herein by reference to Exhibit 10.4 to our Form 10-Q, filed on May 9, 2014)^

- 10.16 Support Agreement, dated as of June 23, 2017, by and among Peoples, Inc., National Bank Holdings Corporation and the undersigned stockholders of Peoples, Inc. (incorporated herein by reference to Exhibit 10.1 to our Form 8-K dated June 23, 2017 and filed on June 27, 2017)
- 10.17 Change of Control Agreement applicable to executive officers not party to an employee agreement (filed herewith)^
- 21.1 Subsidiaries of National Bank Holdings Corporation
- 23.1 Consent of KPMG LLP
- 31.1 Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certifications of CEO and CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101 Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Statements of Financial Condition, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Comprehensive Income (Loss), (iv) the Consolidated Statements of Changes in Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to Consolidated Financial Statements, tagged as blocks of text and in detail\*\*

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\* Schedules and exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K. A copy of any omitted schedule or exhibit will be furnished supplementally to the Securities and Exchange Commission upon request.

\*\* This information is deemed furnished, not filed.

^ Indicates a management contract or compensatory plan.

## 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 February 27, 2018, on its behalf by the undersigned, thereunto duly authorized.

### **National Bank Holdings Corporation**

By /s/ G. Timothy Laney  
G. Timothy Laney  
Chairman, President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on February 27, 2018, by the following persons on behalf of the registrant and in the capacities indicated.



/s/ G. TIMOTHY LANEY

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G. Timothy Laney  
Chairman, President and Chief Executive Officer  
(principal executive officer)

/s/ BRIAN F. LILLY

---

Brian F. Lilly  
Chief Financial Officer; Chief of M&A and Strategy  
(principal financial officer)

/s/ MICHAEL J. DALEY

---

Michael J. Daley  
Chief Accounting Officer  
(principal accounting officer)

/s/ RALPH W. CLERMONT

---

Ralph W. Clermont, Lead Director

/s/ ROBERT E. DEAN

---

Robert E. Dean, Director

/s/ FRED J. JOSEPH

---

Fred J. Joseph, Director

/s/ MICHO F. SPRING

---

Micho F. Spring, Director

/s/ BURNEY S. WARREN, III

---

Burney S. Warren, III, Director

/s/ ART ZEILE

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Art Zeile, Director

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**Corporate Headquarters**

National Bank Holdings Corporation  
7800 East Orchard Road, Suite 300  
Greenwood Village, CO 80111  
Tel: 720.554.6680  
[www.nationalbankholdings.com](http://www.nationalbankholdings.com)

**Stock Exchange Listings**

NYSE  
Symbol: NBHC

**Independent Accountants**

KPMG LLP  
Kansas City, MO

**Transfer Agent, Registrar and  
Dividend Disbursing Agent**

American Stock Exchange &  
Trust Company, LLC  
6201 15th Avenue  
Brooklyn, NY 11219  
Tel: 718.921.8275  
Fax: 718.765.8717  
[www.amstock.com](http://www.amstock.com)

## ■ ABOUT NATIONAL BANK HOLDINGS CORPORATION

National Bank Holdings Corporation is a bank holding company created to build a leading community bank franchise delivering high-quality client service and committed to shareholder results. Through its bank subsidiary, NBH Bank, National Bank Holdings Corporation operates a network of 105 banking centers located in Colorado, the greater Kansas City region, Texas and New Mexico. NBH Bank's comprehensive residential banking group primarily serves the bank's core footprint with additional offices in Arizona, Nevada and Utah. NBH Bank operates under the following brand names: Bank Midwest in Kansas and Missouri, Community Banks of Colorado in Colorado, and Hillcrest Bank in Texas and New Mexico. It also operates as Community Banks Mortgage, a division of NBH Bank, in Arizona, Colorado, Nevada and Utah. More information about National Bank Holdings Corporation can be found at [www.nationalbankholdings.com](http://www.nationalbankholdings.com).

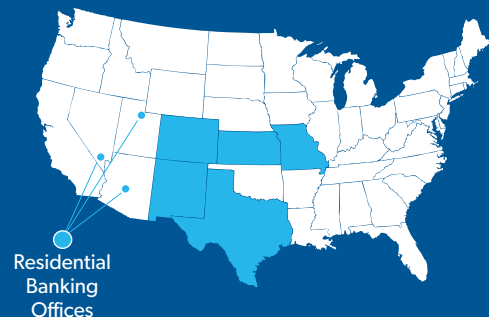
### HISTORY & HIGHLIGHTS

- ▶ Began banking operations in 2010/2011 with four acquisitions in 12 months (three failed banks)
- ▶ Created meaningful scale and market share in the attractive markets of Colorado and Kansas City MSA
- ▶ Experienced and respected management team and board of directors
- ▶ Continuous improvement of profitability and returns
- ▶ Execution of client-centered, relationship-based strategies, delivering accelerating organic revenue growth
- ▶ Built a granular and well-diversified loan portfolio that is well positioned to absorb stress while providing excellent risk-adjusted returns
- ▶ Growing low-cost deposit base in attractive markets
- ▶ Maintenance of a strong expense management focus, with a track record of decreasing annual expenses over the years
- ▶ Remain an opportunistic and disciplined manager of capital, steadily increasing our dividend 80% over the past 2 years
- ▶ Closed accretive \$146 million acquisition of Peoples, Inc. on January 1, 2018, adding meaningful scale in our attractive markets, a best-in-class residential banking platform, a low-cost deposit base and a complementary loan portfolio

### OUR FAMILY OF BRANDS<sup>1</sup>



### LOCATIONS AND MARKET SHARE<sup>2</sup>



#### BANK MIDWEST

47 banking centers  
3.0% deposit market share in Kansas City MSA  
Ranks 5th in banking centers in Kansas City MSA

#### COMMUNITY BANKS OF COLORADO

50 banking centers  
1.5% deposit market share across Colorado  
Ranks 5th in market share of Colorado headquartered banks

#### HILLCREST BANK

8 banking centers, including two commercial and private banking offices located in Austin and Dallas, TX and six banking centers located in Albuquerque and Taos, NM

<sup>1</sup>NBH Bank, Bank Midwest, Community Banks of Colorado, Hillcrest Bank, and the corresponding logo marks, are registered trademarks and service marks, as applicable, of National Bank Holdings Corporation.

<sup>2</sup>Source: S&P Global. Financial information and rank as of June 30, 2017. NBH Bank banking centers as of December 31, 2017 (pro-forma for Peoples).

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