

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549  
**FORM 10-Q**

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

For the quarterly period ended March 31, 2019

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 001-37624

**FIRST WESTERN FINANCIAL, INC.**  
(Exact name of registrant as specified in its charter)

Colorado  
(State or other jurisdiction of  
incorporation or organization)

1900 16th Street, Suite 1200  
Denver, CO  
(Address of principal executive offices)

37-1442266  
(I.R.S. Employer  
Identification No.)

80202  
(Zip Code)

Registrant's telephone number, including area code: 303.531.8100

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 every Interactive Data File required to be submitted 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). ☒ Yes ☐ No

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

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☒

Smaller reporting company ☒

Emerging growth company ☒

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). ☐ Yes ☒ No

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

**Title of each class**  
Common Stock, no par value

**Trading Symbol**  
MYFW

**Name of each exchange on which registered**  
The Nasdaq Stock Market LLC

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

Common Stock, no par value

Shares outstanding as of  
May 6, 2019  
7,983,866

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**Important Notice about Information in this Quarterly Report**

Unless we state otherwise or the context otherwise requires, references in this Quarterly Report to “we,” “our,” “us,” “the Company” and “First Western” refer to First Western Financial, Inc. and its consolidated subsidiaries, including First Western Trust Bank, which we sometimes refer to as “the Bank” or “our Bank.”

The information contained in this Quarterly Report is accurate only as of the date of this Quarterly Report on Form 10-Q and as of the dates specified herein.

## CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements. These forward-looking statements reflect our current views with respect to, among other things, future events and our financial performance. These statements are often, but not always, made through the use of words or phrases such as “may,” “should,” “could,” “predict,” “potential,” “believe,” “will likely result,” “expect,” “continue,” “will,” “anticipate,” “seek,” “estimate,” “intend,” “plan,” “projection,” “would” and “outlook,” or the negative version of those words or other comparable words or phrases of a future or forward-looking nature. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about our industry, management’s beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. Accordingly, we caution you that any such forward-looking statements are not guarantees of future performance and are subject to risks, assumptions and uncertainties that are difficult to predict. Although we believe that the expectations reflected in these forward-looking statements are reasonable as of the date made, actual results may prove to be materially different from the results expressed or implied by the forward-looking statements.

There are or will be important factors that could cause our actual results to differ materially from those indicated in these forward-looking statements, including, but not limited to, the following:

- geographic concentration in Colorado, Arizona, Wyoming and California;
- changes in the economy affecting real estate values and liquidity;
- our ability to continue to originate residential real estate loans and sell such loans;
- risks specific to commercial loans and borrowers;
- claims and litigation pertaining to our fiduciary responsibilities;
- competition for investment managers and professionals and our ability to retain our associates;
- fluctuation in the value of our investment securities;
- the terminable nature of our investment management contracts;
- changes to the level or type of investment activity by our clients;
- investment performance, in either relative or absolute terms;
- changes in interest rates;
- the adequacy of our allowance for credit losses;
- weak economic conditions and global trade;
- legislative changes or the adoption of tax reform policies;
- external business disruptors in the financial services industry;
- liquidity risks;
- our ability to maintain a strong core deposit base or other low-cost funding sources;
- continued positive interaction with and financial health of our referral sources;

- retaining our largest trust clients;
- our ability to achieve our strategic objectives;
- competition from other banks, financial institutions and wealth and investment management firms;
- our ability to implement our internal growth strategy and manage the risks associated with our anticipated growth;
- the acquisition of other banks and financial services companies and integration risks and other unknown risks associated with acquisitions;
- the accuracy of estimates and assumptions;
- our ability to protect against and manage fraudulent activity, breaches of our information security, and cybersecurity attacks;
- our reliance on communications, information, operating and financial control systems technology and related services from third-party service providers;
- technological change;
- our ability to attract and retain clients;
- natural disasters;
- new lines of business or new products and services;
- regulation of the financial services industry;
- legal and regulatory proceedings, investigations and inquiries, fines and sanctions;
- limited trading volume and liquidity in the market for our common stock;
- fluctuations in the market price of our common stock;
- potential impairment of goodwill recorded on our balance sheet and possible requirements to recognize significant charges to earnings due to impairment of intangible assets;
- actual or anticipated issuances or sales of our common stock or preferred stock in the future;
- the initiation and continuation of securities analysts coverage of the Company;
- future issuances of debt securities;
- our ability to manage our existing and future indebtedness;
- available cash flows from the Bank; and
- other factors that are discussed in “Item 1A - Risk Factors” in our Annual Report on Form 10-K.

The foregoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included in our Annual Report on Form 10-K, filed with the U.S. Securities and Exchange Commission (“SEC”) on March 21, 2019. If one or more events related to these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may differ materially from what we anticipate. Accordingly, you should

not place undue reliance on any such forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made, and we do not undertake any obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise. New factors emerge from time to time, and it is not possible for us to predict which will arise. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

**PART I. FINANCIAL INFORMATION**
**ITEM 1. FINANCIAL STATEMENTS**

**FIRST WESTERN FINANCIAL, INC.**  
**CONSOLIDATED BALANCE SHEETS (UNAUDITED)**  
(in thousands, except share amounts)

	<u>March 31,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
<b>ASSETS</b>		
Cash and cash equivalents:		
Cash and due from banks	\$ 2,164	\$ 1,574
Interest-bearing deposits in other financial institutions	67,602	71,783
Total cash and cash equivalents	69,766	73,357
Available-for-sale securities	53,610	43,695
Correspondent bank stock, at cost	993	2,488
Mortgage loans held for sale	19,778	14,832
Loans, net of allowance of \$7,645 and \$7,451	923,545	886,515
Premises and equipment, net	5,815	6,100
Accrued interest receivable	3,053	2,844
Accounts receivable	4,561	4,492
Other receivables	881	1,391
Other real estate owned, net	658	658
Goodwill	24,811	24,811
Other intangible assets, net	229	402
Deferred tax assets, net	4,549	4,306
Company-owned life insurance	14,803	14,709
Other assets	17,636	3,724
Total assets	<u>\$ 1,144,688</u>	<u>\$ 1,084,324</u>
<b>LIABILITIES</b>		
Deposits:		
Noninterest-bearing	\$ 226,484	\$ 202,856
Interest-bearing	751,617	734,902
Total deposits	978,101	937,758
Borrowings:		
Federal Home Loan Bank Topeka borrowings	20,361	15,000
Subordinated Notes	6,560	6,560
Accrued interest payable	329	231
Other liabilities	19,669	7,900
Total liabilities	1,025,020	967,449
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>SHAREHOLDERS' EQUITY</b>		
Preferred stock - no par value; 1,000,000 shares authorized; 0 issued and outstanding	—	—
Convertible preferred stock - no par value; 150,000 shares authorized; 0 shares issued and outstanding	—	—
Common stock - no par value; 10,000,000 shares authorized; 7,968,420 shares issued and outstanding each year at 2019 and 2018	—	—
Additional paid-in capital	141,738	141,359
Accumulated deficit	(21,337)	(23,199)
Accumulated other comprehensive loss	(733)	(1,285)
Total shareholders' equity	119,668	116,875
Total liabilities and shareholders' equity	<u>\$ 1,144,688</u>	<u>\$ 1,084,324</u>

See accompanying notes to consolidated financial statements.

**FIRST WESTERN FINANCIAL, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**  
(in thousands, except per share amounts)

	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
Interest and dividend income:		
Loans, including fees	\$ 10,218	\$ 8,602
Investment securities	310	277
Federal funds sold and other	522	127
Total interest and dividend income	11,050	9,006
Interest expense:		
Deposits	2,909	1,160
Other borrowed funds	170	486
Total interest expense	3,079	1,646
Net interest income	7,971	7,360
Less: Provision for (recovery of) credit losses	194	(187)
Net interest income, after provision for (recovery of) credit losses	7,777	7,547
Non-interest income:		
Trust and investment management fees	4,670	4,954
Net gain on mortgage loans sold	1,456	1,251
Bank fees	289	610
Risk management and insurance fees	468	383
Income on company-owned life insurance	93	94
Total non-interest income	6,976	7,292
Total income before non-interest expense	14,753	14,839
Non-interest expense:		
Salaries and employee benefits	7,618	8,180
Occupancy and equipment	335	375
Lease costs, net	1,072	1,110
Professional services	777	824
Technology and information systems	1,069	1,063
Data processing	687	640
Marketing	278	285
Amortization of other intangible assets	173	230
Other	593	579
Total non-interest expense	12,602	13,286
Income before income taxes	2,151	1,553
Income tax expense	524	367
Net income	1,627	1,186
Preferred stock dividends	—	(561)
Net income available to common shareholders	\$ 1,627	\$ 625
Earnings per common share:		
Basic	\$ 0.21	\$ 0.11
Diluted	\$ 0.21	\$ 0.11

See accompanying notes to consolidated financial statements.

**FIRST WESTERN FINANCIAL, INC.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)**  
**(in thousands)**

	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
Net income	\$ 1,627	\$ 1,186
Other comprehensive income (loss) items:		
Net change in unrealized gains (losses) on available-for-sale securities	1,062	(706)
Income tax effects	(275)	(60)
Total other comprehensive income (loss)	787	(766)
Comprehensive income	<u>\$ 2,414</u>	<u>\$ 420</u>

See accompanying notes to consolidated financial statements.



**FIRST WESTERN FINANCIAL, INC.**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (UNAUDITED)**  
(in thousands, except share amounts)

	Preferred Stock	Shares Convertible Preferred Stock	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (loss)	Total
Balance at January 1, 2018	20,868	41,000	5,833,456	\$ 130,070	\$ (27,296)	\$ (928)	\$ 101,846
Net income	—	—	—	—	1,186	—	1,186
Issuance of common stock, net of issuance costs of \$7	—	—	67,242	1,909	—	—	1,909
Reclassification on unrealized loss on equity securities	—	—	—	—	(41)	41	—
Other comprehensive loss, net of tax	—	—	—	—	—	(766)	(766)
Stock-based compensation	—	—	—	541	—	—	541
Preferred stock dividends	—	—	—	—	(561)	—	(561)
Balance at March 31, 2018	<u>20,868</u>	<u>41,000</u>	<u>5,900,698</u>	<u>\$ 132,520</u>	<u>\$ (26,712)</u>	<u>\$ (1,653)</u>	<u>\$ 104,155</u>
Balance at January 1, 2019	—	—	7,968,420	\$ 141,359	\$ (23,199)	\$ (1,285)	\$ 116,875
Net income	—	—	—	—	1,627	—	1,627
Adoption of ASU 2018-02 - Reclassification of stranded tax effect	—	—	—	—	235	(235)	—
Other comprehensive income, net of tax	—	—	—	—	—	787	787
Stock-based compensation	—	—	—	379	—	—	379
Balance at March 31, 2019	<u>—</u>	<u>—</u>	<u>7,968,420</u>	<u>\$ 141,738</u>	<u>\$ (21,337)</u>	<u>\$ (733)</u>	<u>\$ 119,668</u>

See accompanying notes to consolidated financial statements.

**FIRST WESTERN FINANCIAL, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
(in thousands)

	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
<b>Cash flows from operating activities</b>		
Net income	\$ 1,627	\$ 1,186
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	544	573
Deferred income tax expense	173	177
Stock-based compensation	379	541
Provision for (recovery of) credit losses	194	(187)
Net amortization of investment securities	34	58
Stock dividends received on correspondent bank stock	(6)	(40)
Increase in cash surrender value of company-owned life insurance	(94)	(94)
Net gain on mortgage loans sold	(1,456)	(1,251)
Origination of mortgage loans held for sale	(93,793)	(107,098)
Proceeds from mortgage loans sold	90,286	109,091
Net changes in operating assets and liabilities:		
Accounts receivable	(69)	88
Accrued interest receivable and other assets	(2,447)	269
Accrued interest payable and other liabilities	(1,013)	(1,822)
Net cash (used in) provided by operating activities	(5,641)	1,491
<b>Cash flows from investing activities</b>		
Activity in available-for-sale securities:		
Maturities, prepayments, and calls	2,528	7,585
Purchases	(10,390)	—
Purchases of correspondent bank stock	(362)	(2,081)
Redemption of correspondent bank stock	1,863	1,350
Purchases of premises and equipment	(86)	(43)
Loan and note receivable originations and principal collections, net	(37,207)	(3,551)
Net cash (used in) provided by investing activities	(43,654)	3,260
<b>Cash flows from financing activities</b>		
Net change in deposits	40,343	2,110
Proceeds from issuance of common stock, net	—	1,909
Dividends paid on preferred stock	—	(561)
Payments to Federal Home Loan Bank Topeka borrowings	(5,000)	(83,200)
Proceeds from Federal Home Loan Bank Topeka borrowings	10,361	102,565
Net cash provided by financing activities	45,704	22,823
Net change in cash and cash equivalents	(3,591)	27,574
Cash and cash equivalents, beginning of year	73,357	9,502
<b>Cash and cash equivalents, end of period</b>	<b>\$ 69,766</b>	<b>\$ 37,076</b>
<b>Supplemental cash flow information:</b>		
Interest paid on deposits and borrowed funds	\$ 2,981	\$ 1,627
Income tax refunds received	(70)	—
Cash paid for amounts included in the measurement of lease liabilities	1,299	—
<b>Supplemental noncash disclosures:</b>		
Available-for-sale-reclass of equity securities	(1,300)	703
Adoption of ASU 2018-02 - Reclassification of stranded tax effects	235	—
Change in unrealized gain/(loss)	1,062	(706)
Reclass of unrealized loss on equity securities	—	52
Lease right-of-use-asset obtained in exchange for lease liabilities	16,580	—

See accompanying notes to consolidated financial statements.

**FIRST WESTERN FINANCIAL, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

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

**Business and Basis of Presentation:** The consolidated financial statements include the accounts of First Western Financial, Inc. ("FWFI"), incorporated in Colorado on July 18, 2002, and its direct and indirect wholly-owned subsidiaries listed below (collectively referred to as the "Company").

FWFI is a bank holding company with financial holding company status registered with the Board of Governors of the Federal Reserve System. FWFI wholly owns the following subsidiaries: First Western Trust Bank (the "Bank"), First Western Capital Management Company ("FWCM"), and Ryder, Stilwell Inc. ("RSI"). The Bank wholly owns the following subsidiaries, which are therefore indirectly wholly-owned by FWFI: First Western Merger Corporation ("Merger Corp."), and RRI, LLC ("RRI"). RSI and RRI are not active operating entities.

The Company provides a fully-integrated suite of wealth management services including, private banking, personal trust, investment management, mortgage loans, and institutional asset management services to individual and corporate customers principally in Colorado (metro Denver, Aspen, Boulder and Fort Collins), Arizona (Phoenix and Scottsdale), California (Century City, Los Angeles) and Wyoming (Jackson Hole and Laramie). The Company's revenues are generated from its full range of product offerings as noted above, but principally from net interest income (the interest income earned on the Bank's assets net of funding costs), fee-based wealth advisory, investment management, asset management and personal trust services, and net gains earned on selling mortgage loans.

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). Accordingly, they do not include all the information and footnotes required by GAAP for complete financial statements. The December 31, 2018 consolidated balance sheet has been derived from the audited financial statements for the year ended December 31, 2018.

In the opinion of management, all adjustments that were recurring in nature and considered necessary have been included for fair presentation of the Company's financial position and results of operations. Operating results for the three months ended March 31, 2019 are not necessarily indicative of results that may be expected for the full year ending December 31, 2019. In preparing the consolidated financial statements, the Company is required to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could be significantly different from those estimates.

The consolidated financial statements and notes should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2018 as filed with the SEC.

**Consolidation:** The Company's policy is to consolidate all majority-owned subsidiaries in which it has a controlling financial interest and variable-interest entities where the Company is deemed to be the primary beneficiary. All material intercompany accounts and transactions have been eliminated in consolidation.

**Concentration of Credit Risk:** Most of the Company's lending activity is to customers located in and around Denver, Colorado; Phoenix and Scottsdale, Arizona; and Jackson Hole, Wyoming. The Company does not believe it has significant concentrations in any one industry or customer. At March 31, 2019 and December 31, 2018, 72.6% and 73.6%, respectively, of the Company's loan portfolio was secured by real estate collateral. Declines in real estate values in the primary markets the Company operates in could negatively impact the Company.

**Revenue Recognition:** In accordance with the Financial Accounting Standards Board ("FASB"), Revenue Contracts with Customers ("Topic 606"), trust and investment management fees are earned by providing trust and investment services to customers. The Company's performance obligation under these contracts is satisfied over time as the services are provided. Fees are recognized monthly based on the average monthly value of the assets under management and the corresponding fee rate based on the terms of the contract. Performance based incentive fees are earned with respect to investment management contracts for the three month period ended March 31, 2019 and the year ended December 31, 2018 were immaterial. Receivables are recorded on the consolidated balance sheet in the accounts receivable line item.

Income related to trust and investment management fees, bank fees, and risk management and insurance fees on the consolidated statement of operations for the three months ended March 31, 2019 are considered in scope of Topic 606.

**Reclassifications:** Certain items in prior year financial statements were reclassified to conform to the current presentation. Such reclassifications had no impact on net income or total shareholders' equity.

**Adoption of new accounting standards:** The following reflect recent accounting pronouncements that have been adopted by the Company since the end of the Company's fiscal year ended December 31, 2018.

In February 2016, the FASB issued ASU 2016-02, Lease Accounting (Topic 842) ("ASU 2016-02"). Under ASU 2016-02, a lessee is required to recognize assets and liabilities for leases with lease terms of more than twelve months. Consistent with current GAAP, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. However, unlike current GAAP, which requires only capital leases to be recognized on the balance sheet, ASU 2016-02 requires both types of leases to be recognized on the balance sheet. The ASU also requires disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the financial statements. Upon adoption of ASU 2016-02 with its March 31, 2019 Quarterly Report on Form 10-Q for the three months ended March 31, 2019, the Company recorded a right-of-use asset and related lease liability. We elected the modified retrospective transition approach. We also elected and applied the package of practical expedients whereby we will not reassess prior to the effective date (i) whether any expired contracts contain leases, (ii) the lease classification for any existing or expired lease, and (iii) initial direct costs of any existing leases. See Note 4 – Leases, for further information.

In March 2017, the FASB issued ASU 2017-08, Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20) ("ASU 2017-08"). ASU 2017-08 amends the amortization period for certain purchased callable debt securities held at a premium. Prior to the issuance of this guidance, premiums were amortized as an adjustment of yield over the contractual life of the instrument. ASU 2017-08 requires premiums on purchased callable debt securities that have explicit, non-contingent call features that are callable at fixed prices to be amortized to the earliest call date. There are no accounting changes for securities held at a discount. ASU 2017-08 became effective for the Company beginning January 1, 2019 and did not have a significant impact on the financial statements and disclosures.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities ("ASU 2017-12"), which provided guidance to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. ASU 2017-12 was effective for the Company on January 1, 2019 and did not have a significant impact on the financial statements and disclosures.

In February 2018, the FASB issued ASU 2018-02, Income Statement—Reporting Comprehensive Income (Topic 220) ("ASU 2018-02"). ASU 2018-02 allows an entity to elect to reclassify the stranded tax effects related to the Tax Cuts and Jobs Act of 2017 from accumulated other comprehensive income into retained earnings. ASU 2018-02 was effective for the Company beginning January 1, 2019 and did not have a significant impact on the financial statements and disclosures.

**Recently issued accounting pronouncements, not yet adopted:** The following reflect pending pronouncements with updates to the expected impact since the end of the Company's fiscal year ended December 31, 2018.

In February 2016, the FASB issued ASU 2016-13, Financial Instruments—Credit Losses (Topic 326) ("ASU 2016-13"). ASU 2016-13 replaces the incurred loss model with an expected loss model, which is referred to as the current expected credit loss ("CECL") model. The CECL model is applicable to the measurement of credit losses on the financial assets measured at amortized cost, including loan receivables, held-to-maturity debt securities, and reinsurance receivables. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in leases recognized by a lessor. For all other assets within the scope of CECL, a cumulative-effect adjustment will be recognized in retained earnings as of the beginning of the first reporting period in which the guidance is effective. ASU 2016-13 will be effective for the Company on January 1, 2020. Upon adoption of the amendments within this update, the Company expects to make a cumulative-effect adjustment to the opening balance of retained earnings and the allowance for loan losses in the year of adoption. The Company has formed a CECL committee that is currently working through its implementation plan. The Company is

evaluating historical loan level data requirements and implementing a third-party vendor solution to assist in the application of the model. The Company is also evaluating documentation requirements, internal control structure, relevant data sources, and system configurations. Currently, we are unable to estimate the impact the adoption of this update will have on the consolidated financial statements and disclosures. However, the Company expects the impact of the adoption will be significantly influenced by the composition and characteristics of its loan portfolios along with economic conditions prevalent as of the date of adoption.

## NOTE 2 - INVESTMENT SECURITIES

The following presents the amortized cost and fair value of securities available-for-sale, with gross unrealized gains and losses recognized in accumulated other comprehensive income as of March 31, 2019 and December 31, 2018 (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>March 31, 2019</b>				
Investment securities available-for-sale:				
U.S. Treasury debt	\$ 250	\$ 3	\$ —	\$ 253
Government National Mortgage Association mortgage-backed securities—residential (“GNMA”)	40,146	79	(802)	39,423
Federal National Mortgage Association mortgage-backed securities—residential (“FNMA”)	3,851	6	(111)	3,746
Securities issued by U.S. government sponsored entities and agencies	4,524	—	(124)	4,400
Corporate collateralized mortgage obligations (“CMO”) and mortgage-backed securities (“MBS”)	5,805	18	(35)	5,788
Total securities available-for-sale	<u>\$ 54,576</u>	<u>\$ 106</u>	<u>\$ (1,072)</u>	<u>\$ 53,610</u>
<b>December 31, 2018</b>				
Investment securities available-for-sale:				
U.S. Treasury debt	\$ 250	\$ —	\$ —	\$ 250
GNMA	35,591	8	(1,597)	34,002
FNMA	4,076	2	(208)	3,870
Securities issued by U.S. government sponsored entities and agencies	4,525	—	(223)	4,302
Corporate CMO and MBS	1,281	1	(11)	1,271
Total securities available-for-sale	<u>\$ 45,723</u>	<u>\$ 11</u>	<u>\$ (2,039)</u>	<u>\$ 43,695</u>

At March 31, 2019, the amortized cost and estimated fair value of available-for-sale securities have contractual maturity dates shown in the table below (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

	Amortized Cost	Fair Value
<b>March 31, 2019</b>		
Due within one year through five years	\$ 555	\$ 558
Securities (agency and CMO)	54,021	53,052
Total	<u>\$ 54,576</u>	<u>\$ 53,610</u>

At March 31, 2019 and December 31, 2018, securities with carrying values totaling \$5.3 million and \$5.4 million, respectively, were pledged to secure various public deposits and credit facilities of the Company.

At March 31, 2019 and December 31, 2018, there were no holdings of securities of any one issuer, other than the U.S. Government sponsored entities and agencies, in an amount greater than 10% of shareholders’ equity.

At March 31, 2019 and December 31, 2018, thirty securities and thirty-three securities, respectively were in an unrealized loss position, with unrealized losses totaling \$1.1 million and \$2.0 million, respectively. Twenty-five of the securities in an unrealized loss position at March 31, 2019 have been in a continuous unrealized loss position for more than twelve months, and the remaining securities in a loss position have been in a continuous unrealized loss position for less than 12 months. The unrealized loss positions were caused primarily by interest rate changes and market assumptions about prepayments of principal and interest on the underlying mortgages. Because the decline in market value is attributable to market conditions, not credit quality, and because the Company has the ability and intent to hold these investments until a recovery of fair value, which may be near or at maturity, the Company does not consider these investments to be other-than-temporarily impaired at March 31, 2019.

The following table summarizes securities with unrealized losses at March 31, 2019 and December 31, 2018, aggregated by major security type and length of time in a continuous unrealized loss position (in thousands, before tax):

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>March 31, 2019</b>						
U.S. Treasury debt	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
GNMA	32	—	32,211	(802)	32,243	(802)
FNMA	—	—	3,089	(111)	3,089	(111)
Securities issued by U.S. government sponsored entities and agencies	—	—	4,400	(124)	4,400	(124)
Corporate CMO and MBS	2,406	(34)	64	(1)	2,470	(35)
Total	\$ 2,438	\$ (34)	\$ 39,764	\$ (1,038)	\$ 42,202	\$ (1,072)
<b>December 31, 2018</b>						
U.S. Treasury debt	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
GNMA	201	—	32,696	(1,597)	32,897	(1,597)
FNMA	436	(3)	3,215	(205)	3,651	(208)
Securities issued by U.S. government sponsored entities and agencies	—	—	4,302	(223)	4,302	(223)
Corporate CMO and MBS	1,145	(9)	63	(2)	1,208	(11)
Total	\$ 1,782	\$ (12)	\$ 40,276	\$ (2,027)	\$ 42,058	\$ (2,039)

The Company did not sell any securities during the three months ended March 31, 2019 or during the year ended December 31, 2018.

### NOTE 3 - LOANS AND THE ALLOWANCE FOR LOAN LOSSES

The following presents a summary of the Company's loans as of the dates noted (in thousands):

	March 31, 2019	December 31, 2018
Cash, Securities and Other	\$ 130,641	\$ 114,165
Construction and Development	37,128	31,897
1-4 Family Residential	360,607	350,852
Non-Owner Occupied CRE	172,014	173,741
Owner Occupied CRE	108,873	108,480
Commercial and Industrial	120,602	113,660
Total loans	929,865	892,795
Deferred costs, net	1,325	1,171
Allowance for loan losses	(7,645)	(7,451)
Loans, net	\$ 923,545	\$ 886,515

The following presents, by class, an aging analysis of the recorded investments (excluding accrued interest receivable, deferred loan fees and deferred costs which are not material) in loans past due as of March 31, 2019 and December 31, 2018 (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	90 or More Days Past Due	Total Loans Past Due	Current	Total Recorded Investment
<b>March 31, 2019</b>						
Cash, Securities and Other	\$ 92	\$ —	\$ —	\$ 92	\$130,549	\$130,641
Construction and Development	—	—	—	—	37,128	37,128
1-4 Family Residential	—	—	1,213	1,213	359,394	360,607
Non-Owner Occupied CRE	—	—	—	—	172,014	172,014
Owner Occupied CRE	—	—	—	—	108,873	108,873
Commercial and Industrial	—	—	—	—	120,602	120,602
<b>Total</b>	<b>\$ 92</b>	<b>\$ —</b>	<b>\$ 1,213</b>	<b>\$ 1,305</b>	<b>\$928,560</b>	<b>\$929,865</b>
	30-59 Days Past Due	60-89 Days Past Due	90 or More Days Past Due	Total Loans Past Due	Current	Total Recorded Investment
<b>December 31, 2018</b>						
Cash, Securities and Other	\$ 331	\$ —	\$ 11,252	\$ 11,583	\$ 102,582	\$ 114,165
Construction and Development	—	—	—	—	31,897	31,897
1-4 Family Residential	—	—	1,217	1,217	349,635	350,852
Non-Owner Occupied CRE	567	—	—	567	173,174	173,741
Owner Occupied CRE	—	—	—	—	108,480	108,480
Commercial and Industrial	—	—	1,735	1,735	111,925	113,660
<b>Total</b>	<b>\$ 898</b>	<b>\$ —</b>	<b>\$ 14,204</b>	<b>\$ 15,102</b>	<b>\$ 877,693</b>	<b>\$ 892,795</b>

At March 31, 2019 and December 31, 2018, the Company had a 1-4 Family Residential loan totaling \$1.2 million, which was 90 days delinquent and accruing interest.

#### *Non-Accrual Loans and Troubled Debt Restructurings (“TDR”)*

The following presents the recorded investment in non-accrual loans by class as of the dates noted (in thousands):

	March 31, 2019	December 31, 2018
Non-accrual loans		
Cash, Securities and Other	\$ 10,977	\$ 11,252
Construction and Development	—	—
1-4 Family Residential	—	—
Non-Owner Occupied CRE	—	—
Owner Occupied CRE	—	—
Commercial and Industrial	1,435	1,735
<b>Total</b>	<b>\$ 12,412</b>	<b>\$ 12,987</b>

At March 31, 2019 and December 31, 2018, the non-accrual loans listed above were classified as TDR with a recorded investment totaling \$12.4 million and \$13.0 million, respectively. Non-accrual loans include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following presents a summary of the unpaid principal balance of loans classified as TDRs as of the dates noted (in thousands):

	March 31, 2019	December 31, 2018
Cash, Securities, and Other	\$ 10,977	\$ 11,252
Commercial and Industrial	6,523	6,583
Total	\$ 17,500	\$ 17,835
Allowance for loan associated with TDR	(940)	(940)
Net recorded investment	\$ 16,560	\$ 16,895

At March 31, 2019, the Company extended an additional \$0.3 million of funds to a borrower with a loan classified as a TDR for operational needs driven by weather delays. The majority owner for this borrower provided \$1.5 million of pledged cash as collateral in exchange for this additional funding. At December 31, 2018, the Company had not committed any additional funds to a borrower with a loan classified as a TDR.

The Company did not modify any loans into a TDR for the three months ended March 31, 2019 and 2018. The Company modified two loans into a TDR for the year ended December 31, 2018.

For the three months ended March 31, 2019, an \$11.0 million loan classified as Cash, Securities, and Other, which was classified as a TDR and not accruing interest, was not making payments in accordance with the modified terms. For the year ended December 31, 2018, this loan was not making payments in accordance with the original contract terms. The loan was placed on non-accrual status and classified as a TDR during the year ended December 31, 2018. The loan was making payments as agreed for the three months ended March 31, 2018.

One loan classified as Commercial and Industrial of \$5.1 million, which was accruing interest and classified as a TDR at March 31, 2019 and December 31, 2018, was making payments in accordance with its modified terms for the three months ended March 31, 2019 and the year ended December 31, 2018. The loan was making payments as agreed for the three months ended March 31, 2018.

The other Commercial and Industrial loan of \$1.4 million classified as a TDR and not accruing interest at March 31, 2019 and December 31, 2018 was making payments in accordance with its modified terms for the three months ended March 31, 2019 and the year ended December 31, 2018. As of and for the three months ended March 31, 2018, this loan was classified as a TDR and was not making payments in accordance with the modified terms.

TDRs are reviewed individually for impairment and are included in the Company's specific reserves in the allowance for loan losses. If charged off, the amount of the charge-off is included in the Company's charge-off factors, which impact the Company's reserves on non-impaired loans.



The following presents the Company's recorded investment in impaired loans as of the periods presented (in thousands):

	Total Recorded Investment	Recorded Investment With No Allowance	Recorded Investment With Allowance	Allowance for Loan Losses	Unpaid Contractual Principal Balance	Average Recorded Investment	Interest Income Recognized
<b>March 31, 2019</b>							
Cash, Securities, and Other	10,977	10,977			10,977	11,114	—
Commercial and Industrial	6,523	5,088	1,435	940	6,523	6,553	120
Total	\$ 17,500	\$ 16,065	\$ 1,435	\$ 940	\$ 17,500	\$ 17,667	\$ 120
<b>March 31, 2018</b>							
Commercial and Industrial	\$ 1,835	\$ —	\$ 1,835	\$ 722	\$ 1,835	\$ 1,835	\$ —
Total	\$ 1,835	\$ —	\$ 1,835	\$ 722	\$ 1,835	\$ 1,835	\$ —
<b>December 31, 2018</b>							
Cash, Securities, and Other	11,252	11,252	—	—	11,252	4,506	—
Commercial and Industrial	6,583	4,848	1,735	940	6,583	5,820	34
Total	\$ 17,835	\$ 16,100	\$ 1,735	\$ 940	\$ 17,835	\$ 10,326	\$ 34

The recorded investment in loans in the previous tables excludes accrued interest and deferred loan fees and costs due to their immateriality. Interest income, if any, was recognized on the cash basis on non-accrual loans.

#### Allowance for Loan Losses

Allocation of a portion of the allowance for loan losses to one category of loans does not preclude its availability to absorb losses in other categories. The following presents the activity in the Company's allowance for loan losses by portfolio class for the periods presented (in thousands):

	Cash, Securities and Other	Construction and Development	1-4 Family Residential	Non-Owner Occupied CRE	Owner Occupied CRE	Commercial and Industrial	Total
<b>Changes in allowance for loan losses for the three months ended March 31, 2019</b>							
Beginning balance	\$ 764	\$ 232	\$ 2,552	\$ 1,264	\$ 789	\$ 1,850	\$ 7,451
Provision for (recovery of) credit losses	113	34	36	(29)	(9)	49	194
Charge-offs	—	—	—	—	—	—	—
Recoveries	—	—	—	—	—	—	—
Ending balance	\$ 877	\$ 266	\$ 2,588	\$ 1,235	\$ 780	\$ 1,899	\$ 7,645
<b>Allowance for loan losses at March 31, 2019 allocated to loans evaluated for impairment:</b>							
Individually	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 940	\$ 940
Collectively	877	266	2,588	1,235	780	959	6,705
Ending balance	\$ 877	\$ 266	\$ 2,588	\$ 1,235	\$ 780	\$ 1,899	\$ 7,645
<b>Loans at March 31, 2019, evaluated for impairment:</b>							
Individually	\$ 10,977	\$ —	\$ —	\$ —	\$ —	\$ 6,523	\$ 17,500
Collectively	119,664	37,128	360,607	172,014	108,873	114,079	912,365
Ending balance	\$ 130,641	\$ 37,128	\$ 360,607	\$ 172,014	\$ 108,873	\$ 120,602	\$ 929,865

	Cash, Securities and Other	Construction and Development	1-4 Family Residential	Non-Owner Occupied CRE	Owner Occupied CRE	Commercial and Industrial	Total
<b>Changes in allowance for loan losses for the three months ended March 31, 2018</b>							
Beginning balance	\$ 1,066	\$ 202	\$ 2,283	\$ 1,433	\$ 751	\$ 1,552	\$ 7,287
Provision for (recovery of) credit losses	(97)	26	51	(120)	(27)	(20)	(187)
Charge-offs	—	—	—	—	—	—	—
Recoveries	—	—	—	—	—	—	—
Ending balance	<u>\$ 969</u>	<u>\$ 228</u>	<u>\$ 2,334</u>	<u>\$ 1,313</u>	<u>\$ 724</u>	<u>\$ 1,532</u>	<u>\$ 7,100</u>
<b>Allowance for loan losses at December 31, 2018 allocated to loans evaluated for impairment:</b>							
Individually	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 940	\$ 940
Collectively	764	232	2,552	1,264	789	910	6,511
Ending balance	<u>\$ 764</u>	<u>\$ 232</u>	<u>\$ 2,552</u>	<u>\$ 1,264</u>	<u>\$ 789</u>	<u>\$ 1,850</u>	<u>\$ 7,451</u>
<b>Loans at December 31, 2018, evaluated for impairment:</b>							
Individually	\$ 11,252	\$ —	\$ —	\$ —	\$ —	\$ 6,583	\$ 17,835
Collectively	102,913	31,897	350,852	173,741	108,480	107,077	874,960
Ending balance	<u>\$ 114,165</u>	<u>\$ 31,897</u>	<u>\$ 350,852</u>	<u>\$ 173,741</u>	<u>\$ 108,480</u>	<u>\$ 113,660</u>	<u>\$ 892,795</u>

The Company categorizes loans into risk categories based on relevant information about the ability of the borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk on a quarterly basis. The Company uses the following definitions for risk ratings:

**Special Mention**—Loans classified as special mention have a potential weakness or borrowing relationships that require more than the usual amount of management attention. Adverse industry conditions, deteriorating financial conditions, declining trends, management problems, documentation deficiencies or other similar weaknesses may be evident. Ability to meet current payment schedules may be questionable, even though interest and principal are still being paid as agreed. The asset has potential weaknesses that may result in deteriorating repayment prospects if left uncorrected. Loans in this risk grade are not considered adversely classified.

**Substandard**—Substandard loans are considered “classified” and are inadequately protected by the current net worth and paying capacity of the obligor or by the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardizes the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Loans in this category may be placed on non-accrual status and may individually be evaluated for impairment if indicators of impairment exist.

**Doubtful**—Loans graded Doubtful are considered “classified” and have all the weaknesses inherent in those classified as Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable. However, the amount of certainty of eventual loss is not known because of specific pending factors.

Loans not meeting any of the three criteria above are considered to be pass-rated loans. The following presents, by class and by credit quality indicator, the recorded investment in the Company’s loans as of March 31, 2019 and December 31, 2018 (in thousands):

<b>March 31, 2019</b>	<b>Pass</b>	<b>Special Mention</b>	<b>Substandard</b>	<b>Total</b>
Cash, Securities and Other	\$ 119,664	\$ —	\$ 10,977	\$ 130,641
Construction and Development	37,128	—	—	37,128
1-4 Family Residential	359,394	—	1,213	360,607
Non-Owner Occupied CRE	162,294	9,260	460	172,014
Owner Occupied CRE	108,873	—	—	108,873
Commercial and Industrial	108,082	—	12,520	120,602
<b>Total</b>	<b>\$ 895,435</b>	<b>\$ 9,260</b>	<b>\$ 25,170</b>	<b>\$ 929,865</b>

December 31, 2018	Pass	Special Mention	Substandard	Total
Cash, Securities and Other	\$ 102,913	\$ —	\$ 11,252	\$ 114,165
Construction and Development	31,897	—	—	31,897
1-4 Family Residential	349,635	—	1,217	350,852
Non-Owner Occupied CRE	165,164	8,117	460	173,741
Owner Occupied CRE	108,480	—	—	108,480
Commercial and Industrial	100,929	—	12,731	113,660
Total	\$ 859,018	\$ 8,117	\$ 25,660	\$ 892,795

#### NOTE 4 – LEASES

A lease is defined as a contract that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration. The Company adopted ASC 842 on January 1, 2019 and recorded an initial right-of-use asset and related lease liability of \$12.9 million and \$16.6 million, respectively. There was no cumulative effect upon adoption.

Leases in which the Company is determined to be the lessee are primarily operating leases comprised of real estate property and office space for our corporate headquarters and profit centers with terms that extend to 2025. Certain properties contain portions that are subleased with terms that extend through 2020. In accordance with ASC 842, operating leases are required to be recognized as a right-of-use asset with a corresponding lease liability.

The following table represents the classification of the right-of-use asset and corresponding liability within the consolidated balance sheet. The Company elected to not include short-term leases with initial terms of twelve months or less, on the consolidated balance sheet.

		March 31, 2019
<b>Lease Right-of-Use Assets</b>	<b>Classification</b>	
Operating lease right-of-use asset	Other assets	\$ 12,229
<b>Lease Liabilities</b>	<b>Classification</b>	
Operating lease liabilities	Other liabilities	\$ 15,833

The Company's operating lease agreements typically include an option to renew the lease at the Company's discretion. To the extent the Company is reasonably certain it will exercise the renewal option at the inception of the lease, the Company will include the extended term in the calculation of the right-of-use asset and lease liability. ASC 842 requires the use of the rate implicit in the lease when it is readily determinable. As this rate is typically not readily determinable, at the inception of the lease, the Company uses its collateralized incremental borrowing rate over a similar term. The amount of the right-of-use asset and lease liability are impacted by the discount rate used to calculate the present value of the minimum lease payments over the term of the lease.

	March 31, 2019
<b>Weighted-average remaining lease term</b>	
Operating leases	5.45 years
<b>Weighted-average discount rate</b>	
Operating leases	3.69 %

The Company's operating leases contain fixed and variable lease components and it has elected to account for all classes of underlying assets as a single lease component. Variable lease costs primarily represent common area maintenance and parking. The following table represents the Company's net lease costs.

	March 31, 2019
<b>Lease Costs</b>	
Operating lease cost	\$ 783
Variable lease cost	388
Sublease income	(99)
<b>Lease costs, net</b>	<b>\$ 1,072</b>

The following table represents a maturity analysis of the Company's operating lease liabilities on an annual basis for each of the first five years and total amounts thereafter as of March 31, 2019.

	Operating Leases
<b>Twelve Months Ended</b>	
March 31, 2020	\$ 3,698
March 31, 2021	3,267
March 31, 2022	2,754
March 31, 2023	2,666
March 31, 2024	2,253
Thereafter	2,883
<b>Total Future Minimum Lease Payments</b>	<b>\$ 17,521</b>
Less: Imputed interest	(1,688)
<b>Present Value of Net Future Minimum Lease Payments</b>	<b>\$ 15,833</b>

The following presents minimum lease payments due pursuant to the leases as of December 31, 2018 for the years indicated.

Year	Operating Leases
2019	\$ 3,570
2020	3,374
2021	2,815
2022	2,675
2023	2,358
Thereafter	3,446
	<b>\$ 18,238</b>

## NOTE 5 - DEPOSITS

The following presents the Company's interest-bearing deposits at the dates noted (in thousands):

	March 31, 2019	December 31, 2018
Money market deposit accounts	\$ 513,328	\$ 489,506
Time deposits	176,312	178,743
Negotiable order of withdrawal accounts	59,464	64,853
Savings accounts	2,513	1,800
Total interest bearing deposits	<b>\$ 751,617</b>	<b>\$ 734,902</b>
Aggregate time deposits of \$250,000 or greater	<b>\$ 80,692</b>	<b>\$ 83,550</b>

Overdraft balances classified as loans totaled \$0.1 million and \$0.3 million at March 31, 2019 and December 31, 2018, respectively.

## NOTE 6 - BORROWINGS

### FHLB Topeka Borrowings

The Bank has executed a blanket pledge and security agreement with the Federal Home Loan Bank (“FHLB”) Topeka that requires certain loans and securities be pledged as collateral for any outstanding borrowings under the agreement. The collateral pledged as of March 31, 2019 and December 31, 2018 amounted to \$519.1 million and \$475.4 million, respectively. Based on this collateral and the Company’s holdings of FHLB Topeka stock, the Company was eligible to borrow an additional \$331.6 million at March 31, 2019. Each advance is payable at its maturity date.

The Company had the following borrowings from FHLB Topeka at the dates noted (in thousands):

<u>Maturity Date</u>	<u>Rate %</u>	<u>March 31, 2019</u>	<u>December 31, 2018</u>
August 2, 2019	2.64	\$ 10,361	\$ 5,000
August 26, 2020	1.94	10,000	10,000
Total		<u>\$ 20,361</u>	<u>\$ 15,000</u>

The Bank has borrowing capacity associated with three unsecured federal funds lines of credit up to \$10.0 million, \$13.0 million, and \$25.0 million. As of March 31, 2019 and December 31, 2018, there were no amounts outstanding on any of the federal funds lines.

The Company’s borrowing facilities include various financial and other covenants, including, but not limited to, a requirement that the Bank maintains regulatory capital that is deemed “well capitalized” by federal banking agencies (see Note 15). As of March 31, 2019 and December 31, 2018, the Company was in compliance with the covenant requirements.

Effective July 26, 2018, the Company also redeemed all of its subordinated notes due 2020 for an aggregate redemption price of \$6.9 million, including accrued and unpaid interest. The subordinated notes due 2020 were redeemed using the proceeds from the Company’s initial public offering, which closed on July 23, 2018.

## NOTE 7 – COMMITMENTS AND CONTINGENCIES

The Bank is party to credit-related financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. Commitments may expire without being utilized. The Bank’s exposure to credit loss is represented by the contractual amount of these commitments, although material losses are not anticipated. The Bank follows the same credit policies in making commitments as it does for on-balance sheet instruments.

The following presents the Company’s financial instruments whose contract amounts represent credit risk, as of the dates noted (in thousands):

	<u>March 31, 2019</u>		<u>December 31, 2018</u>	
	<u>Fixed Rate</u>	<u>Variable Rate</u>	<u>Fixed Rate</u>	<u>Variable Rate</u>
Unused lines of credit	\$ 24,041	\$ 243,186	\$ 33,571	\$ 271,580
Standby letters of credit	\$ 65	\$ 23,508	\$ 40	\$ 23,508
Commitments to make loans to sell	\$ 42,237	\$ —	\$ 17,207	\$ —
Commitments to make loans	\$ 27,782	\$ 39,045	\$ 2,750	\$ 19,762

Unused lines of credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Several of the commitments may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management’s credit evaluation of the customer.

Unused lines of credit under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are uncollateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Bank is committed.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Substantially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds collateral supporting those commitments if deemed necessary.

Commitments to make loans to sell are agreements to sell a loan to an investor in the secondary market for which the interest rate has been locked with the customer, provided there is no violation of any condition within the contract with either party. Commitments to make loans to sell have fixed interest rates. Since commitments may expire without being extended, total commitment amounts may not necessarily represent cash requirements.

Commitments to make loans are agreements to lend to a customer, provided there is no violation of any condition within the contract. Commitments to make loans generally have fixed expiration dates or other termination clauses. Since commitments may expire without being extended, total commitment amounts may not necessarily represent cash requirements.

### **Litigation, Claims and Settlements**

The Company, from time to time, is involved in various legal actions arising in the normal course of business. While the ultimate outcome of any such proceedings cannot be predicted with certainty, it is the opinion of management, based on advice from legal counsel, that no proceedings exist, either individually or in the aggregate, which, if determined adversely to the Company, would have a material effect on the Company's consolidated financial statements.

## **NOTE 8 – SHAREHOLDERS EQUITY**

### **Common Stock**

The Company's common stock has no par value and each holder of common stock is entitled to one vote for each share (though certain voting restrictions may exist on non-vested restricted stock) held.

During the three months ended March 31, 2019 the Company sold no shares of common stock. During the three months ended March 31, 2018, the Company sold 67,242 shares of its common stock through a Private Placement Memorandum ("PPM") resulting in proceeds to the Company of \$1.9 million (net of issuance costs of an immaterial amount).

On July 23, 2018, the Company completed its initial public offering of 1,921,775 shares of its common stock at a price of \$19.00 per share, which included 296,250 shares pursuant to the full exercise by the underwriters of their option to purchase additional shares of common stock from the Company, resulting in net proceeds of \$32.5 million (net of issuance costs of \$4.4 million).

Effective July 26, 2018, the Company redeemed at par value all of its outstanding shares of preferred stock, which consisted of 8,559 shares of Series A preferred stock, 428 shares of Series B preferred stock, 11,881 shares of Series C preferred stock, and 41,000 shares of Series D preferred stock. The aggregate redemption amount for the preferred stock was \$25.0 million. The preferred stock was redeemed using the proceeds from the Company's initial public offering, which closed on July 23, 2018.

Certain of our common stock holders received Make Whole Rights pursuant to an Investor Agreement in connection with the conversion of Series D preferred stock into common stock and our private placement conducted from August 2017 to February 2018, which entitled the holder of such Make Whole Rights to, among other things, receive additional shares of our common stock ("Make Whole Shares"), subject to the satisfaction of the conditions of the Investor Agreements. As a result, the Company issued 128,978 Make Whole Shares on September 10, 2018. The Company's

issuance of the Make Whole Shares was exempt from the registration statement of the Securities Act pursuant to Section 4(a)(2) thereof.

### Restricted Stock Awards

As of March 31, 2019, the Restricted Stock Awards have a weighted-average grant date fair value of \$28.50 per share. During the three months ended March 31, 2019 and 2018, the Company has recognized compensation expense of \$0.1 million in each period for the Restricted Stock Awards. As of March 31, 2019 and 2018, the Company has \$2.6 million and \$2.9 million, respectively, of unrecognized stock-based compensation expense related to the shares issued. As of March 31, 2019, the unrecognized stock-based compensation expense is expected to be recognized over a weighted average period of three and one-half years. No Restricted Stock Awards vested during the three month period ended March 31, 2019 and 2018.

### Stock-Based Compensation Plans

As of March 31, 2019, there were a total of 717,804 shares available for issuance under the First Western Financial, Inc. 2016 Omnibus Incentive Plan ("the 2016 Plan"). As of March 31, 2019, if the 449,797 options outstanding under the First Western 2008 Stock Incentive Plan ("the 2008 Plan") are forfeited, cancelled or terminated with no consideration paid to the Company, those amounts will be transferred to the 2016 Plan and increase the number of shares eligible to be granted under the 2016 Plan to a maximum of 1,167,601 shares.

### Stock Options

The Company did not grant any stock options during the three months ended March 31, 2019 and 2018.

During the three months ended March 31, 2019 and 2018, the Company recognized stock-based compensation expense of \$0.1 million and \$0.2 million, respectively, associated with stock options. As of March 31, 2019 and 2018, the Company has \$0.5 million and \$1.2 million, respectively, of unrecognized stock-based compensation expense related to stock options which are unvested. As of March 31, 2019, the unrecognized cost is expected to be recognized over a weighted-average period of approximately one year.

The following summarizes activity for nonqualified stock options for the three months ended March 31, 2019:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at beginning of year	465,947	\$ 28.84		
Granted	—	—		
Exercised	—	—		
Forfeited or expired	(16,150)	\$ 28.05		
Outstanding at end of period	449,797	\$ 28.87	4.3	(a)
Options fully vested / exercisable at March 31, 2019	393,416	\$ 29.50	4.0	(a)

(a) Nonqualified stock options outstanding at the end of the period and those fully vested / exercisable had immaterial aggregate intrinsic values.

As of March 31, 2019 and December 31, 2018, there were 393,416 and 402,872 options, respectively, that were exercisable. Exercise prices are between \$20.00 and \$40.00 per share, and the options are exercisable for a period of ten-years from the original grant date and expire on various dates between 2022 and 2026.

### Share Awards

Pursuant to the 2016 Plan, the Company can grant associates and non-associate directors long-term cash and stock-based compensation. During the three months ended March 31, 2019, the Company granted certain associates

restricted stock units which are earned over time or based on various performance measures and convert to common stock upon vesting, which are summarized here and expanded further below:

The following summarizes the activity for the Time Vesting Units, the Financial Performance Units and the Market Performance Units for the three months ended March 31, 2019:

	Time Vesting Units	Financial Performance Units	Market Performance Units
Outstanding at beginning of year	184,369	15,932	17,258
Granted	3,779	—	—
Vested	—	—	—
Forfeited	(7,092)	(802)	(401)
Outstanding at end of period	181,056	15,130	16,857

#### Time Vesting Units

The Time Vesting Units are granted to full-time associates and board members at the date approved by the Company's board of directors. The Company granted 3,779 Time Vesting Units with a five-year service period in 2019 that vest in equal installments of 50% on the third and fifth anniversaries of the grant date, assuming continuous employment through the scheduled vesting dates. The Time Vesting Units granted in 2019 have a weighted-average grant-date fair value of \$14.55 per unit. During the three months ended March 31, 2019 and 2018, the Company recognized compensation expense of \$0.2 million and \$0.3 million, respectively, for the Time Vesting Units. As of March 31, 2019 and 2018, there was \$3.5 million and \$4.7 million, respectively, of unrecognized compensation expense related to the Time Vesting Units. As of March 31, 2019, the unrecognized stock-based compensation expense is expected to be recognized over a weighted-average period of approximately two years.

#### Financial Performance Units

The Financial Performance Units were granted to certain key associates and are earned based on the Company achieving various financial performance metrics beginning on the grant date and ending on December 31, 2020. If the Company achieves the financial metrics, which include various thresholds from 0% up to 150%, then the Financial Performance Units will have a subsequent two-year service period vesting requirement ending on December 31, 2021. There were no Financial Performance Units granted during the three months ended March 31, 2019. As of March 31, 2019, the Company is accruing at the maximum threshold for 50% of the awards and the threshold for the remainder. The maximum shares that can be issued at 150% as of March 31, 2019 was 22,695 shares. During the three months ended March 31, 2019 and 2018, the Company recognized an immaterial amount in each period, respectively, of compensation expense for the Financial Performance Units. As of March 31, 2019 and 2018, there was \$0.2 million and \$0.5 million, respectively, of unrecognized compensation expense related to the Financial Performance Units. As of March 31, 2019, the unrecognized stock-based compensation expense is expected to be recognized over a weighted-average period of two and three-quarter years.

#### Market Performance Units

Market Performance Units were granted to certain key associates and are earned based on growth in the value of the Company's common stock and were dependent on the Company completing an initial public offering of stock during a defined period of time. If the Company's common stock is trading at or above certain prices, over a performance period ending on June 30, 2020, the Market Performance Units will be determined to be earned and vest following the completion of a subsequent service period ending on June 30, 2022.

On July 23, 2018, the Company completed its initial public offering and the Market Performance Units performance condition was met. Subsequent to the performance condition there is also a market condition as a vesting requirement for the Market Performance Units which affects the determination of the grant date fair value. The Company estimated the grant date fair value using various valuation assumptions. During the three months ended March 31, 2019, the Company recognized an immaterial amount of compensation expense for the Market Performance Units. As of March 31, 2019, there was an immaterial amount of unrecognized compensation expense related to the Market Performance Units which is expected to be recognized over a weighted-average period of three and one-quarter years.



## NOTE 9 - EARNINGS PER COMMON SHARE

The table below presents the calculation of basic and diluted earnings per common share for the periods indicated (amounts in thousands, except share and per share amounts):

	Three Months Ended March 31,	
	2019	2018
<b>Earnings per common share - Basic</b>		
Numerator:		
Net income	\$ 1,627	\$ 1,186
Dividends on preferred stock	—	(561)
Net income available for common shareholders	<u>\$ 1,627</u>	<u>\$ 625</u>
Denominator:		
Basic weighted average shares	7,873,718	5,870,813
Earnings per common share - basic	<u>\$ 0.21</u>	<u>\$ 0.11</u>
<b>Earnings per common share - Diluted</b>		
Numerator:		
Net income	\$ 1,627	\$ 1,186
Dividends on preferred stock	—	(561)
Net income available for common shareholders	<u>\$ 1,627</u>	<u>\$ 625</u>
Denominator:		
Basic weighted average shares	7,873,718	5,870,813
Diluted effect of common stock equivalents:		
Stock options	—	29,939
Time Vesting Units	2,080	30,565
Financial Performance Units	—	3,161
Market Performance Units	13,846	—
Restricted Stock Awards	—	3,948
Total diluted effect of common stock equivalents	<u>15,926</u>	<u>67,613</u>
Diluted weighted average shares	<u>7,889,644</u>	<u>5,938,426</u>
Earnings per common share - diluted	<u>\$ 0.21</u>	<u>\$ 0.11</u>

Diluted earnings per share was computed without consideration to potentially dilutive instruments as their inclusion would have been anti-dilutive. As of March 31, 2019 and 2018, potentially dilutive securities excluded from the diluted earnings per share calculation are as follows:

	For the Three Months Ended March 31,	
	2019	2018
Stock options	449,797	215,200
Convertible Preferred D shares	—	151,700
Time Vesting Units	159,991	—
Financial Performance Units	15,130	—
Market Performance Units	—	—
Restricted Stock Awards	94,736	—
Total potentially dilutive securities	<u>719,654</u>	<u>366,900</u>

## NOTE 10 - INCOME TAXES

During the three months ended March 31, 2019 and 2018, the Company recorded an income tax provision of \$0.5 million and \$0.4 million, respectively, reflecting an effective tax rate of 24.4% and 23.6%, respectively.

**NOTE 11 – RELATED-PARTY TRANSACTIONS**

The Bank granted loans to principal officers and directors and their affiliates, all of whom are deemed related parties. At March 31, 2019 and December 31, 2018, there were no delinquent or non-performing loans to any officer or director of the Company. The following presents a summary of related-party loan activity as of the dates noted (in thousands):

	<b>March 31, 2019</b>	<b>December 31, 2018</b>
Balance, beginning of year	\$ 2,659	\$ 14,077
Funded loans	988	1,466
Payments collected	(8)	(9,386)
Changes in related parties	—	(3,498)
Balance, end of year	<u>\$ 3,639</u>	<u>\$ 2,659</u>

Deposits from related parties held by the Bank at March 31, 2019 and December 31, 2018 totaled \$39.1 million and \$36.7 million, respectively.

The Company leases office space from an entity controlled by one of the Company's board members. During of the three months ended March 31, 2019 and 2018, the Company incurred an immaterial amount of expense related to this lease.

Effective July 23, 2018, the Company redeemed its subordinated notes due 2020. A director of the Company was a subscription holder of such notes. Upon redemption, the Company incurred a principal and interest payment of \$0.1 million.

**NOTE 12 - FAIR VALUE**

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

- Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

There were no transfers between levels during the three months ended March 31, 2019 or 2018. The Company used the following methods and significant assumptions to estimate fair value:

**Investment Securities:** The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

**Interest Rate Locks and Forward Delivery Commitments:** Fair values of these mortgage derivatives are estimated based on changes in mortgage interest rates from the date the commitment related to the loan is locked. The fair value estimate is based on valuation models using market data from secondary market loan sales and direct contacts with third party investors as of the measurement date (Level 2).

Derivative instruments are carried at fair value in the Company's financial statements. The accounting for changes in the fair value of a derivative instrument are accounted for within the consolidated statements of income.

The following presents assets measured on a recurring basis at March 31, 2019 and December 31, 2018 (in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Reported Balance
<b>March 31, 2019</b>				
Investment securities available-for-sale:				
U.S. Treasury debt	\$ 253	\$ —	\$ —	\$ 253
GNMA	—	39,423	—	39,423
FNMA	—	3,746	—	3,746
Securities issued by US. Government sponsored entities and agencies	—	4,400	—	4,400
Corporate CMO and MBS	—	5,788	—	5,788
Total securities available-for-sale	\$ 253	\$ 53,357	\$ —	\$ 53,610
Equity securities	\$ 702	\$ —	\$ —	\$ 702
Interest rate lock and forward delivery commitments	\$ —	\$ 1,525	\$ —	\$ 1,525
<b>December 31, 2018</b>				
Investment securities available-for-sale:				
U.S. Treasury debt	\$ 250	\$ —	\$ —	\$ 250
GNMA	—	34,002	—	34,002
FNMA	—	3,870	—	3,870
Securities issued by US. Government sponsored entities and agencies	—	4,302	—	4,302
Corporate CMO and MBS	—	1,271	—	1,271
Total securities available-for-sale	\$ 250	\$ 43,445	\$ —	\$ 43,695
Equity securities	\$ 693	\$ —	\$ —	\$ 693
Interest rate lock and forward delivery commitments	\$ —	\$ 890	\$ —	\$ 890

Equity securities and U.S. Treasury debt are reported at fair value utilizing Level 1 inputs. The remaining portfolio of securities are reported at fair value with Level 2 inputs provided by a pricing service. As of March 31, 2019 and December 31, 2018, the majority of the securities have credit support provided by the Federal Home Loan Mortgage Corporation, GNMA, and the Federal National Mortgage Association. Factors used to value the securities by the pricing service include: benchmark yields, reported trades, interest spreads, prepayments, and other market research. In addition, ratings and collateral quality are considered.

As of March 31, 2019, equity securities have been recorded at fair value within the other assets line item in the consolidated balance sheet with changes recorded in the other line item in the consolidated statement of income (in thousands).

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

**Impaired Loans:** The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent appraisals. These appraisals may utilize a single valuation approach or a combination of

approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments can be significant and typically result in Level 3 classifications of the inputs for determining fair value. Impaired loans are evaluated quarterly for additional impairment and adjusted accordingly.

Appraisals for both collateral-dependent impaired loans and other real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, the Company reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics.

The following presents assets measured on a nonrecurring basis as of March 31, 2019 and December 31, 2018 (in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Reported Balance
<b>March 31, 2019</b>				
Other real estate owned:				
Commercial properties	\$ —	\$ —	\$ 658	\$ 658
Total other real estate owned	\$ —	\$ —	\$ 658	\$ 658
Total impaired loans:				
Commercial and industrial	—	—	495	495
Total impaired loans	\$ —	\$ —	\$ 495	\$ 495
<b>December 31, 2018</b>				
Other real estate owned:				
Commercial properties	\$ —	\$ —	\$ 658	\$ 658
Total other real estate owned	\$ —	\$ —	\$ 658	\$ 658
Total impaired loans:				
Commercial and industrial	\$ —	—	795	795
Total impaired loans	\$ —	\$ —	\$ 795	\$ 795

The sales comparison approach was utilized for estimating the fair value of non-recurring assets.

At March 31, 2019, other real estate owned remained unchanged from December 31, 2018 and had a carrying amount of \$0.7 million, which is the cost basis of \$2.4 million net of a valuation allowance of \$1.7 million.

At March 31, 2019, total impaired loans measured for impairment using the fair value of the collateral for collateral dependent loans had carrying values of \$1.4 million with valuation allowances of \$0.9 million and were classified as Level 3. As of December 31, 2018, impaired loans measured for impairment using the fair value of the collateral for collateral dependent loans had carrying values of \$1.7 million with valuation allowances of \$0.9 million and were classified as Level 3. Impaired loans valued using a discounted cash flow analyses were not deemed to be at fair value at March 31, 2019 and December 31, 2018.

Impaired loans accounted for provisions for loan losses of \$0 for each of the three month periods ended March 31, 2019 and 2018.

The following presents carrying amounts and estimated fair values for financial instruments as of March 31, 2019 and December 31, 2018 (in thousands):

March 31, 2019	Carrying Amount	Fair Value Measurements Using:			
		Level 1	Level 2	Level 3	
Assets:					
Cash and cash equivalents	\$ 69,766	\$ 69,766	\$ —	\$ —	
Securities available-for-sale	53,610	253	53,357	—	
Loans, net	923,545	—	—	905,205	
Mortgage loans held for sale	19,778	—	19,778	—	
Accrued interest receivable	3,053	—	3,053	—	
Other assets	702	702	—	—	
Liabilities:					
Deposits	\$ 978,101	\$ —	\$ 980,258	\$ —	
Borrowings:					
FHLB Topeka Borrowings – fixed rate	20,361	—	20,249	—	
2016 Subordinated notes – fixed-to-floating rate	6,560	—	—	6,325	
Accrued interest payable	329	—	329	—	
December 31, 2018	Carrying Amount	Fair Value Measurements Using:			
		Level 1	Level 2	Level 3	
Assets:					
Cash and cash equivalents	\$ 73,357	\$ 73,357	\$ —	\$ —	
Securities available-for-sale	43,695	250	43,445	—	
Loans, net	886,515	—	—	868,828	
Mortgage loans held for sale	14,832	—	14,832	—	
Accrued interest receivable	2,844	—	2,844	—	
Other assets	693	693	—	—	
Liabilities:					
Deposits	\$ 937,758	\$ —	\$ 940,039	\$ —	
Borrowings:					
FHLB Topeka Borrowings – fixed rate	15,000	—	14,833	—	
2016 Subordinated notes – fixed-to-floating rate	6,560	—	—	6,434	
Accrued interest payable	231	—	231	—	

The fair value estimates presented and discussed above are based on pertinent information available to management as of the dates specified. The estimated fair value amounts are based on the exit price notion set forth by ASU 2016-01 effective January 1, 2018 on a prospective basis.

### NOTE 13 - SEGMENT REPORTING

The Company's reportable segments consist of Wealth Management, Capital Management, and Mortgage. The chief operating decision maker ("CODM") is the Chief Executive Officer. The measure of profit or loss used by the CODM to identify and measure the Company's reportable segments is income before income tax.

The Wealth Management segment consists of operations relative to the Company's fully integrated wealth management products and services. Services provided include deposit, loan, insurance, and trust and investment management advisory products and services.

The Capital Management segment consists of operations relative to the Company's institutional investment management services over proprietary fixed income, high yield, and equity strategies, including the advisor of three listed mutual funds. Capital Management products and services are financial in nature for which revenues are based on a percentage of assets under management or paid premiums.

The Mortgage segment consists of operations relative to the Company's residential mortgage service offerings. Mortgage products and services are financial in nature for which premiums are recognized net of expenses, upon the sale of mortgage loans to third parties.

The tables below present the financial information for each segment that is specifically identifiable or based on allocations using internal methods for the three months ended March 31, 2019 and 2018 (in thousands):

Three Months Ended March 31, 2019	Wealth Management	Capital Management	Mortgage	Consolidated
<b>Income Statement</b>				
Total interest income	\$ 11,050	\$ —	\$ —	\$ 11,050
Total interest expense	3,079	—	—	3,079
Provision for loan losses	194	—	—	194
Net interest income	7,777	—	—	7,777
Non-interest income	4,732	765	1,479	6,976
Total income	12,509	765	1,479	14,753
Depreciation and amortization expense	348	131	65	544
All other non-interest expense	10,050	695	1,313	12,058
Income (loss) before income tax	\$ 2,111	\$ (61)	\$ 101	\$ 2,151
Goodwill	\$ 15,994	\$ 8,817	\$ —	\$ 24,811
<b>Total assets</b>	<b>\$ 1,114,800</b>	<b>\$ 10,110</b>	<b>\$ 19,778</b>	<b>\$ 1,144,688</b>
<b>Three Months Ended March 31, 2018</b>				
<b>Income Statement</b>				
Total interest income	\$ 9,006	\$ —	\$ —	\$ 9,006
Total interest expense	1,646	—	—	1,646
Provision for loan losses	(187)	—	—	(187)
Net interest income	7,547	—	—	7,547
Non-interest income	5,164	861	1,267	7,292
Total income	12,711	861	1,267	14,839
Depreciation and amortization expense	337	132	104	573
All other non-interest expense	10,122	1,194	1,397	12,713
Income (loss) before income tax	\$ 2,252	\$ (465)	\$ (234)	\$ 1,553
Goodwill	\$ 15,994	\$ 8,817	\$ —	\$ 24,811
<b>Total assets</b>	<b>\$ 958,511</b>	<b>\$ 10,964</b>	<b>\$ 22,146</b>	<b>\$ 991,621</b>

#### NOTE 14 - SUPPLEMENTAL FINANCIAL DATA

Other non-interest expense as shown in the consolidated statements of income is detailed in the following schedule to the extent the components exceed one percent of the aggregate of total interest income and other income (in thousands).

Other non-interest expense	Three Months Ended March 31,	
	2019	2018
Corporate development and related	\$ 378	\$ 285
Loan and deposit related	127	204
Other	88	90
Total other non-interest expense	\$ 593	\$ 579

#### NOTE 15 - REGULATORY CAPITAL MATTERS

The Bank is subject to various regulatory capital adequacy requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and, additionally for banks, the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets,

liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification is also subject to qualitative judgments by the regulators regarding components, risk weightings and other factors. The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks ("Basel III rules") became effective for the Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital. Management believes as of March 31, 2019, the Bank meets all capital adequacy requirements to which it is subject to.

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

The standard ratios established by the Bank's primary regulators to measure capital require the Bank to maintain minimum amounts and ratios, set forth in the following table. These ratios are common equity Tier 1 capital ("CET 1"), Tier 1 capital and total capital (as defined in the regulations) to risk-weighted assets (as defined), and Tier 1 capital (as defined) to average assets (as defined).

Actual capital ratios of the Bank, along with the applicable regulatory capital requirements as of March 31, 2019, which were calculated in accordance with the requirements of Basel III, became effective January 1, 2015. The final rules of Basel III also established a "capital conservation buffer" of 2.5% above new regulatory minimum capital ratios, that are fully effective in 2019, and resulted in the following minimum ratios: (i) a CET 1 ratio of 7.0%; (ii) a Tier 1 capital ratio of 8.5%; and (iii) a total capital ratio of 10.5%. The new capital conservation buffer requirement began phasing in, in January 2016 at 0.625% of risk-weighted assets and increased each year until fully implemented in January 2019. An institution is subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations will establish a maximum percentage of eligible retained income that can be utilized for such activities. At March 31, 2019, required ratios including the capital conservation buffer were (i) CET 1 of 7.0%; (ii) a Tier 1 capital ratio of 8.5%; and (iii) a total capital ratio of 10.5%.

As of March 31, 2019 and December 31, 2018, the most recent filings with the Federal Deposit Insurance Corporation ("FDIC") categorized the Bank as well capitalized under the regulatory guidelines. To be categorized as well capitalized, an institution must maintain minimum CET 1 risk-based, Tier 1 risk-based, total risk-based, and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since March 31, 2019, the Company believes have changed the categorization of the Bank as well capitalized. Management believes the Bank met all capital adequacy requirements to which it was subject to as of March 31, 2019 and December 31, 2018.

The following presents the actual and required capital amounts and ratios as of March 31, 2019 and December 31, 2018 (in thousands):

	Actual		Required for Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>March 31, 2019</b>						
Common Equity Tier 1(CET1) to risk-weighted assets						
Bank	\$ 89,773	10.36 %	\$ 38,999	4.5 %	\$ 56,331	6.5 %
Consolidated	96,799	11.13	N/A	N/A	N/A	N/A
Tier 1 capital to risk-weighted assets						
Bank	89,773	10.36	51,998	6.0	69,331	8.0
Consolidated	96,799	11.13	N/A	N/A	N/A	N/A
Total capital to risk-weighted assets						
Bank	97,564	11.26	69,331	8.0	86,664	10.0
Consolidated	111,149	12.78	N/A	N/A	N/A	N/A
Tier 1 capital to average assets						
Bank	89,773	8.07	44,513	4.0	55,642	5.0
Consolidated	96,799	8.67	N/A	N/A	N/A	N/A
<b>December 31, 2018</b>						
Common Equity Tier 1(CET1) to risk-weighted assets						
Bank	\$ 87,291	10.55 %	\$ 37,240	4.5 %	\$ 53,791	6.5 %
Consolidated	94,335	11.35	N/A	N/A	N/A	N/A
Tier 1 capital to risk-weighted assets						
Bank	87,291	10.55	49,653	6.0	66,204	8.0
Consolidated	94,335	11.35	N/A	N/A	N/A	N/A
Total capital to risk-weighted assets						
Bank	94,906	11.47	66,204	8.0	82,755	10.0
Consolidated	108,510	13.06	N/A	N/A	N/A	N/A
Tier 1 capital to average assets						
Bank	87,291	8.63	40,459	4.0	50,574	5.0
Consolidated	94,335	9.28	N/A	N/A	N/A	N/A

#### NOTE 16 – SUBSEQUENT EVENTS

##### May 2019 Time Vesting Units and Financial Performance Units

On May 1, 2019, the Company granted 67,810 Time Vesting Units and 59,767 Financial Performance Units to officers and other key employees. All Time Vesting Units granted on May 1, 2019, have a ten-year term and vest in five substantially equal annual installments beginning on May 1, 2020, subject to continued service. The potential unrecognized compensation expense on the grant date for the Time Vesting Units to be recognized over the vesting period is approximately \$0.8 million. All Financial Performance Units granted on May 1, 2019, have a ten-year term and are earned based on the Company achieving various financial metrics beginning on the grant date and ending on December 31, 2021, which include various thresholds from 0% to 150%, then the Financial Performance Units will have a subsequent two-year service period vesting requirement ending on December 31, 2023. The potential maximum unrecognized compensation expense on the grant date for the Financial Performance Units to be recognized over the vesting period is approximately \$1.4 million.

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## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion and analysis is intended to assist readers in understanding our financial condition as of and results of operations for the three months ended March 31, 2019 and should be read in conjunction with our consolidated financial statements and the accompanying notes thereto included in this Quarterly Report on Form 10-Q (this "Form 10-Q") and in our Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC") on March 21, 2019. Unless we state otherwise or the context otherwise requires, references in this Form 10-Q to "we," "our," "us," "the Company" and "First Western" refer to First Western Financial, Inc. and its consolidated subsidiaries, including First Western Trust Bank, which we sometimes refer to as "the Bank" or "our Bank."*

*The following discussion contains "forward-looking statements" that reflect our future plans, estimates, beliefs and expected performance. We caution that assumptions, expectations, projections, intentions or beliefs about future events may, and often do, vary from actual results and the differences can be material. See "Cautionary Note Regarding Forward-Looking Statements." Also, see the risk factors and other cautionary statements described under the heading "Risk Factors" included in in our Annual report Form 10-K filed with the SEC on March 21, 2019 and in Part II–Item 1A of this Form 10-Q. We do not undertake any obligation to publicly update any forward-looking statements except as otherwise required by applicable law.*

### **Company Overview**

We are a financial holding company founded in 2002 and headquartered in Denver, Colorado. We provide a fully integrated suite of wealth management services to our clients including banking, trust and investment management products and services. Our mission is to be the best private bank for the Western wealth management client. We believe that the "Western wealth management client" shares our entrepreneurial spirit and values our sophisticated, high-touch wealth management services that are tailored to meet their specific needs. We target entrepreneurs, professionals and high-net worth individuals, typically with \$1.0 million-plus in liquid net worth, and their related philanthropic and business organizations. We partner with our clients to solve their unique financial needs through our expert integrated services provided in a team approach.

We offer our services through a branded network of boutique private trust bank offices, which we believe are strategically located in affluent and high-growth markets in locations across Colorado, Arizona, Wyoming and California. Our profit centers, which are comprised of private bankers, lenders, wealth planners and portfolio managers, under the leadership of a local chairman and/or president, are also supported centrally by teams providing management services such as operations, risk management, credit administration, technology support, human capital and accounting/finance services, which we refer to as support centers.

From 2004, when we opened our first profit center, until March 31, 2019, we have expanded our footprint into nine full service profit centers, two mortgage loan production offices, two trust offices, and one registered investment advisor located across four states. As of and for the three months ended March 31, 2019, we had \$1.1 billion in total assets, \$14.8 million in total income before non-interest expense and provided fiduciary and advisory services on \$5.8 billion of assets under management ("AUM").

### **Primary Factors Used to Evaluate the Results of Operations**

As a financial institution, we manage and evaluate various aspects of both our results of operations and our financial condition. We evaluate the comparative levels and trends of the line items in our consolidated balance sheet and income statement as well as various financial ratios that are commonly used in our industry. The primary factors we use to evaluate our results of operations include net interest income, non-interest income and non-interest expense.

#### *Net Interest Income*

Net interest income represents interest income less interest expense. We generate interest income on interest-earning assets, primarily loans and available-for-sale securities. We incur interest expense on interest-bearing liabilities, primarily interest-bearing deposits and borrowings. To evaluate net interest income, we measure and monitor: (i) yields on loans, available-for-sale securities and other interest-earning assets; (ii) the costs of deposits and other funding sources; (iii) the rates incurred on borrowings and other interest-bearing liabilities; and (iv) the regulatory risk weighting associated with the assets. Interest income is primarily impacted by loan growth and loan repayments, along with changes in interest

rates on the loans. Interest expense is primarily impacted by changes in deposit balances along with the volume and type of interest-bearing liabilities. Net interest income is primarily impacted by changes in market interest rates, the slope of the yield curve, and interest we earn on interest-earning assets or pay on interest-bearing liabilities.

#### *Non-Interest Income*

Non-interest income primarily consists of the following:

- *Trust and investment management fees*—fees and other sources of income charged to clients for managing their trust and investment assets, providing financial planning consulting services, 401(k) and retirement advisory consulting services, and other wealth management services. Trust and investment management fees are primarily impacted by rates charged and increases and decreases in AUM. AUM is primarily impacted by opening and closing of client advisory and trust accounts, contributions and withdrawals, and the fluctuation in market values.
- *Net mortgage gains*—gain on originating and selling mortgages, origination fees, and borrower credits, less commissions to loan originators, lender credits, document review and other costs specific to originating and selling the loan. The market adjustments for interest rate lock commitments that have funded and gains and losses incurred on the mandatory trading of loans are also included in this line item. Net mortgage gains are primarily impacted by the amount of loans sold, the type of loans sold and market conditions.
- *Banking fees*—income generated through bank-related service charges such as: electronic transfer fees, treasury management fees, bill pay fees, and other banking fees. Banking fees are primarily impacted by the level of business activities and cash movement activities of our clients.
- *Risk management and insurance fees*—commissions earned on insurance policies we have placed for clients through our client risk management team who incorporate insurance services, primarily life insurance, to support our clients' wealth planning needs. Our insurance revenues are primarily impacted by the type and volume of policies placed for our clients.
- *Income on company-owned life insurance*—income earned on the growth of the cash surrender value of life insurance policies we hold on certain key associates. The income on the increase in the cash surrender value is non-taxable income.

#### *Non-Interest Expense*

Non-interest expense is comprised primarily of the following:

- *Salaries and employee benefits*—include all forms of compensation related expenses including salary, incentive compensation, payroll-related taxes, stock-based compensation, benefit plans, health insurance, 401(k) plan match costs and other benefit-related expenses. Salaries and employee benefit costs are primarily impacted by changes in headcount and fluctuations in benefits costs.
- *Occupancy and equipment*—costs related to leasing our office space, depreciation charges for the furniture, fixtures and equipment, amortization of leasehold improvements, utilities and other occupancy-related expenses. Occupancy and equipment costs are primarily impacted by the number of locations we occupy.
- *Professional services*—costs related to legal, accounting, tax, consulting, personnel recruiting, insurance and other outsourcing arrangements. Professional services costs are primarily impacted by corporate activities requiring specialized services. FDIC insurance expense is also included in this line and represents the assessments that we pay to the FDIC for deposit insurance.
- *Technology and information systems*—costs related to software and information technology services to support office activities and internal networks. Technology and information system costs are primarily impacted by the number of locations we occupy, the number of associates we have and the level of service we require from our third-party technology vendors.

- *Data processing*—costs related to processing fees paid to our third-party data processing system providers relating to our core private trust banking platform. Data processing costs are primarily impacted by the number of loan, deposit and trust accounts we have and the level of transactions processed for our clients.
- *Marketing*—costs related to promoting our business through advertising, promotions, charitable events, sponsorships, donations and other marketing-related expenses. Marketing costs are primarily impacted by the levels of advertising programs and other marketing activities and events held throughout the year.
- *Amortization*—primarily represents the amortization of intangible assets including client lists and other similar items recognized in connection with acquisitions.
- *Other operational expenses*—includes costs related to expenses associated with office supplies, postage, travel expenses, meals and entertainment, dues and memberships, costs to maintain or prepare OREO for sale, director compensation and travel, and other general corporate expenses that do not fit within one of the specific non-interest expense lines described above. Other operational expenses are generally impacted by our business activities and needs.

### *Operating Segments*

We measure the overall profitability of operating segments based on income before income tax. We believe this is a more useful measurement as our wealth management products and services are fully integrated with our private trust bank. We allocate costs to our segments, which consist primarily of compensation and overhead expense directly attributable to the products and services within Wealth Management, Capital Management and Mortgage segments. We measure the profitability of each segment based on a post-allocation basis as we believe it better approximates the operating cash flows generated by our reportable operating segments. A description of each segment is provided in Note 13 - Segment Reporting of the accompanying Notes to the Consolidated Financial Statements.

### **Primary Factors Used to Evaluate our Balance Sheet**

The primary factors we use to evaluate our balance sheet include asset and liability levels, asset quality, capital, liquidity, and potential profit production of assets.

We manage our asset levels to ensure our lending initiatives are efficiently and profitably supported and to ensure we have the necessary liquidity and capital to meet the required regulatory capital ratios. Funding needs are evaluated and forecasted by communicating with clients, reviewing loan maturity and draw expectations, and projecting new loan opportunities.

We manage the diversification and quality of our assets based upon factors that include the level, distribution, severity and trend of problem; classified, delinquent, non-accrual, non-performing and restructured assets; the adequacy of our allowance for loan losses; the diversification and quality of loan and investment portfolios; the extent of counterparty risks, credit risk concentrations, and other factors.

We manage our liquidity based upon factors that include the level and quality of capital and our overall financial condition, the trend and volume of problem assets, our balance sheet risk exposure, the level of deposits as a percentage of total loans, the amount of non-deposit funding used to fund assets, the availability of unused funding sources and off-balance sheet obligations, the availability of assets to be readily converted into cash without undue loss, the amount of cash and liquid securities we hold, and other factors.

Financial institution regulators have established guidelines for minimum capital ratios for banks and bank holding companies. During the first quarter of 2015, the Bank adopted the new Basel III regulatory capital framework as approved by federal banking agencies, which are subject to a multi-year phase-in period. The adoption of this new framework modified the calculation of the various capital ratios, added a new ratio, CET 1, and revised the adequately and well capitalized thresholds. In addition, Basel III establishes a capital conservation buffer of 2.5% of risk-weighted assets, which is phased in over a four-year period beginning January 1, 2016. At March 31, 2019, our Bank capital ratios exceeded the current well capitalized regulatory requirements established under Basel III.

## Results of Operations

### Overview

*The three months ended March 31, 2019 compared with the three months ended March 31, 2018.* We reported net income available to common shareholders of \$1.6 million for the three months ended March 31, 2019, compared to \$0.6 million of net income available to common shareholders, after paying dividends to preferred shareholders for March 31, 2018, a \$1.0 million, or 160.3% increase. For the three months ended March 31, 2019, our income before income tax was \$2.2 million, a \$0.6 million, or 38.5%, increase from March 31, 2018. For the three months ended March 31, 2019, income before income tax increased primarily as a result of a \$0.6 million, or 8.3%, increase in net interest income compared to the three months ended March 31, 2018. For the three months ended March 31, 2019, net income was \$1.6 million, a \$0.4 million, or 37.2% increase compared to the three months ended March 31, 2018.

### Net Interest Income

*The three months ended March 31, 2019 compared with the three months ended March 31, 2018.* For the three months ended March 31, 2019, net interest income, before the provision for loan losses was \$8.0 million, an increase of \$0.6 million, or 8.3%, compared to the three months ended March 31, 2018. This increase was partially attributable to a \$103.6 million increase in average outstanding loan balances compared to March 31, 2018, along with an increase in our average yield on loans to 4.46% from 4.20% for the three months ended March 31, 2019 and 2018, respectively. For the three months ended March 31, 2019, our net interest margin was 3.03% and our net interest spread was 2.62%. For the three months ended March 31, 2018, our net interest margin was 3.25% and our net interest spread was 2.99%.

The increase in average loans outstanding for the three months ended March 31, 2019 compared to the same period in 2018 was primarily due to growth in all of our major loan categories except for commercial real estate. Net interest income is also impacted by changes in the amount and type of interest earning assets and interest bearing liabilities. To evaluate net interest income, we measure and monitor the yields on our loans and other interest earning assets and the costs of our deposits and other funding sources.

Interest income on our available-for-sale securities portfolio increased as a result of higher average yield for the three months ended March 31, 2019 compared to the same period in 2018, partially offset by a lower average balance. Our average yield on available-for-sale securities during the three months ended March 31, 2019 was 2.46%, a 32 basis point increase from the three months ended March 31, 2018. Our average available-for-sale securities balance during the three months ended March 31, 2019 was \$50.5 million, a slight decrease of \$1.3 million from the three months ended March 31, 2018.

Interest expense on deposits increased during the three months ended March 31, 2019 compared to the same period in 2018, driven primarily by a rising rate environment and mix of deposit type, which resulted in increases in rates on depository accounts as cost of funds increased to 1.23% from 0.74%. In addition, average interest-bearing deposit accounts increased \$165.4 million for the three months ended March 31, 2019, compared to the same period in 2018.

The following tables present an analysis of net interest income and net interest margin for the periods presented, using daily average balances for each major category of interest-earning assets and interest-bearing liabilities, the interest earned or paid and the average rate earned or paid on those assets or liabilities.

	As of and For the Three Months Ended March 31,					
	2019			2018		
(Dollars in thousands)	Average Balance <sup>(1)</sup>	Interest Earned / Paid	Average Yield / Rate	Average Balance <sup>(1)</sup>	Interest Earned / Paid	Average Yield / Rate
<b>Assets</b>						
Interest-earning assets:						
Interest-bearing deposits in other financial institutions	\$ 85,826	\$ 522	2.43 %	\$ 36,375	\$ 127	1.40 %
Available-for-sale securities <sup>(2)</sup>	50,474	310	2.46 %	51,732	277	2.14 %
Loans <sup>(3)</sup>	915,921	10,218	4.46 %	812,306	8,537	4.20 %
Promissory notes from related parties <sup>(4)</sup>	—	—	— %	5,756	65	4.52 %
Interest-earning assets <sup>(5)</sup>	1,052,221	11,050	4.20 %	906,169	9,006	3.98 %
Mortgage loans held-for-sale <sup>(6)</sup>	13,277	126	3.80 %	18,416	200	4.34 %
Total interest-earning assets, plus loans held-for-sale	1,065,498	11,176	4.20 %	924,585	9,206	3.98 %
Allowance for loan losses	(7,567)			(7,170)		
Noninterest-earning assets	77,780			72,070		
Total assets	\$ 1,135,711			\$ 989,485		
<b>Liabilities and Shareholders' Equity</b>						
Interest-bearing liabilities:						
Interest-bearing deposits	\$ 760,507	\$ 2,909	1.53 %	\$ 595,148	\$ 1,160	0.78 %
Federal Home Loan Bank Topeka borrowings	10,401	50	1.92 %	55,517	229	1.65 %
Subordinated notes	6,560	120	7.32 %	13,436	257	7.65 %
Total interest-bearing liabilities	777,468	3,079	1.58 %	664,101	1,646	0.99 %
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	220,408			214,980		
Other liabilities	19,413			7,049		
Total noninterest-bearing liabilities	239,821			222,029		
Shareholders' equity	118,422			103,355		
Total liabilities and shareholders' equity	\$ 1,135,711			\$ 989,485		
Net interest rate spread <sup>(7)</sup>			2.62 %			2.99 %
Net interest income <sup>(8)</sup>		\$ 7,971			\$ 7,360	
Net interest margin <sup>(9)</sup>			3.03 %			3.25 %

- (1) Average balance represents daily averages, unless otherwise noted.
- (2) Available-for-sale securities represents monthly averages.
- (3) Non-performing loans are included in the respective average loan balances. Income, if any, on such loans is recognized on a cash basis.
- (4) Promissory notes from related parties were reclassified to loans in 2018.
- (5) Tax-equivalent yield adjustments are immaterial.
- (6) Mortgage loans held-for-sale are separated from the interest-earning assets above, as these loans are held for a short period of time until sold in the secondary market and are not held for investment purposes, with interest income recognized in the net mortgage gain line in the income statement. These balances are excluded from the margin calculations in these tables.
- (7) Net interest spread is the average yield on interest-earning assets (excludes mortgage loans held-for-sale) minus the average rate on interest-bearing liabilities.
- (8) Net interest income is income earned on interest-earning assets, which does not include interest earned on mortgage loans held-for-sale.
- (9) Net interest margin is equal to net interest income divided by average interest-earning assets (excludes mortgage loans held-for-sale).

The following tables present the dollar amount of changes in interest income and interest expense for the periods presented, for each component of interest-earning assets and interest-bearing liabilities (excluding mortgage loans held-

for-sale) and distinguishes between changes attributable to volume and interest rates. Changes attributable to both rate and volume that cannot be separated have been allocated to volume.

(Dollars in thousands)	Three Months Ended March 31, 2019 Compared to 2018		
	Increase (Decrease) Due to Change in:		Total Increase (Decrease)
	Volume	Rate	
Interest-earning assets:			
Interest-bearing deposits in other financial institutions	\$ 301	\$ 94	\$ 395
Available-for-sale securities	(8)	41	33
Loans	1,156	525	1,681
Promissory notes from related parties	—	(65)	(65)
Total increase in interest income	\$ 1,449	\$ 595	\$ 2,044
Interest-bearing liabilities:			
Interest-bearing deposits	633	1,116	1,749
Federal Home Loan Bank Topeka borrowings	(219)	40	(179)
Subordinated notes	(125)	(12)	(137)
Total increase in interest expense	\$ 289	\$ 1,144	\$ 1,433
Increase (decrease) in net interest income	\$ 1,160	\$ (549)	\$ 611

#### Non-Interest Income

The three months ended March 31, 2019 compared with the three months ended March 31, 2018. For the three months ended March 31, 2019 compared to the three months ended March 31, 2018, non-interest income decreased \$0.3 million, or 4.3%, to \$7.0 million. The decrease in non-interest income during the three months ended March 31, 2019 was primarily a result of a decrease in trust and investment management fees of \$0.3 million and bank fees of \$0.3 million, partially offset by an increase in risk management fees of \$0.1 million and a \$0.2 million increase in net gain on mortgage loans sold, compared to the same period in 2018.

The table below presents the significant categories of our non-interest income for the three months ended March 31, 2019 and 2018:

(Dollars in thousands)	Three Months Ended March 31,		Change	
	2019	2018	\$	%
Non-interest income:				
Trust and investment management fees	\$ 4,670	\$ 4,954	\$ (284)	(5.7)%
Net gain on mortgage loans sold	1,456	1,251	205	16.4 %
Banking fees	289	610	(321)	(52.6)%
Risk management and insurance fees	468	383	85	22.2 %
Income on company-owned life insurance	93	94	(1)	(1.1)%
Total non-interest income	\$ 6,976	\$ 7,292	\$ (316)	(4.3)%

*Trust and investment management fees*— For the three months ended March 31, 2019 compared to the same period in 2018, our trust and investment management fees declined in the Wealth Management segment by \$0.2 million, or 4.6 %, and our trust and investment management fees declined within our Capital Management segment by \$0.1 million, or 11.1%. The decrease was primarily attributable to closed accounts within one profit center due to attrition with the relationship of a prior president.

*Net gain on mortgage loans sold*— For the three months ended March 31, 2019 compared to the three months ended March 31, 2018, our net gain on mortgage loans sold increased by \$0.2 million, or 16.4%, to \$1.5 million. For the three months ended March 31, 2019 and 2018, our average net gain on sale was 161 and 115 basis points, respectively, on loans sold. The net gain on sales of loans will fluctuate with the amount and type of loans sold and market conditions. The increase in gain on mortgage loans sold for the three month period was primarily related to an increase in margin, primarily related to favorable pricing conditions year over year, partially offset by a decrease in origination volume in 2019 compared to 2018.

**Risk management and insurance fees**— Risk management fees include fees earned by our risk management product group as a result of assisting clients with obtaining life insurance policies and fees from the trailing annuity revenue streams. During three months ended March 31, 2019, we recognized \$0.5 million of risk management fees as compared to \$0.4 million for the same period in 2018. The increase in 2019 was attributed to an increase in the size and number of client policies placed.

#### *Provision for Credit Losses*

For the three months ended March 31, 2019, we recorded \$0.2 million of provision for credit loss primarily driven by growth in our loan portfolio. For the three months ended March 31, 2018, we released \$0.2 million for our provision for credit loss as result of our continued efforts to reduce our problem loans, which resulted in lower specific provisions and a reduction in our loan loss factors applied to our non-individually evaluated loan pools as a result of lower charge-offs over the corresponding look-back period utilized in our provision calculation. We have a dedicated problem loan resolution team comprised of associates from our credit, senior leadership, risk and accounting teams that meets frequently to minimize losses by ensuring that watch list and problem credits are identified early and actively worked in order to identify potential losses in a timely manner and proactively manage the corresponding accounts.

#### *Non-Interest Expense*

The table below presents the significant categories of our non-interest expense for the periods noted:

(Dollars in thousands)	Three Months Ended March 31,		Change	
	2019	2018	\$	%
<b>Non-interest expense:</b>				
Salaries and employee benefits	\$ 7,618	\$ 8,180	\$ (562)	(6.9)%
Occupancy and equipment	335	375	(40)	(10.7)%
Lease expense	1,072	1,110	(38)	(3.4)%
Professional services	777	824	(47)	(5.7)%
Technology and information systems	1,069	1,063	6	0.6 %
Data processing	687	640	47	7.3 %
Marketing	278	285	(7)	(2.5)%
Amortization of other intangible assets	173	230	(57)	(24.8)%
Other operational	593	579	14	2.4 %
<b>Total non-interest expense</b>	<b>\$ 12,602</b>	<b>\$ 13,286</b>	<b>\$ (684)</b>	<b>(5.1)%</b>

Generally, the decrease in non-interest expense of 5.1% to \$12.6 million for the three months ended March 31, 2019 was due to a decrease in headcount impacting salaries, equity compensation, and payroll taxes, partially offset by an increase in health insurance premiums.

#### *Income Tax*

During the three months ended March 31, 2019 and 2018, the Company recorded an income tax provision of \$0.5 million and \$0.4 million, respectively, reflecting an effective tax rate of 24.4% and 23.6%, respectively.

#### **Segment Reporting**

We have three reportable operating segments: Wealth Management, Capital Management and Mortgage. Our Wealth Management segment consists of operations relating to our fully integrated wealth management business. Services provided by our Wealth Management segment include deposit, loan, insurance, and trust and investment management advisory products and services. Our Capital Management segment consists of operations relating to our institutional investment management services over proprietary fixed income, high yield and equity strategies, including acting as the advisor of three owned, managed and rated proprietary mutual funds. Capital management products and services are financial in nature, with revenues generally based on a percentage of assets under management or paid premiums. Our Mortgage segment consists of operations relating to the origination and sale of residential mortgage loans. Mortgage products and services are financial in nature, with gains and fees recognized net of expenses, upon the sale of mortgage loans to third parties. Services provided by our Mortgage segment include soliciting, originating and selling mortgage

loans into the secondary market. Mortgage loans originated and held for investment purposes are recorded in the Wealth Management segment, as this segment provides on-going services to our clients.

The following table presents key metrics related to our segments:

	Three Months Ended March 31, 2019			
	Wealth Management	Capital Management	Mortgage	Consolidated
<i>(Dollars in thousands)</i>				
Income <sup>(1)</sup>	\$ 12,509	\$ 765	\$ 1,479	\$ 14,753
Income before taxes	\$ 2,111	\$ (61)	\$ 101	\$ 2,151
Profit margin	16.9 %	(8.0)%	6.8 %	14.6 %

  

	Three Months Ended March 31, 2018			
	Wealth Management	Capital Management	Mortgage	Consolidated
<i>(Dollars in thousands)</i>				
Income <sup>(1)</sup>	\$ 12,711	\$ 861	\$ 1,267	\$ 14,839
Income before taxes	\$ 2,252	\$ (465)	\$ (234)	\$ 1,553
Profit margin	17.7 %	(54.0)%	(18.5)%	10.5 %

(1) Net interest income plus non-interest income.

The tables below present selected financial metrics of each segment as of and for the periods presented:

#### Wealth Management

	As of and For the Three Months Ended March 31,		\$ Change	% Change
	2019	2018		
<i>(Dollars in thousands)</i>				
Total interest income	\$ 11,050	\$ 9,006	\$ 2,044	22.7 %
Total interest expense	3,079	1,646	1,433	87.1 %
Provision for loan losses	194	(187)	381	(203.7)%
Net interest income	7,777	7,547	230	3.0 %
Non-interest income	4,732	5,164	(432)	(8.4)%
Total income	12,509	12,711	(202)	(1.6)%
Depreciation and amortization expense	348	337	11	3.3 %
All other non-interest expense	10,050	10,122	(72)	(0.7)%
Income before income tax	\$ 2,111	\$ 2,252	\$ (141)	(6.3)%
Goodwill	\$ 15,994	\$ 15,994	\$ —	— %
Identifiable assets	\$ 1,114,800	\$ 958,511	\$ 156,289	16.3 %

The Wealth Management segment reported income before income tax of \$2.1 million and \$2.3 million for the three months ended March 31, 2019 and 2018, respectively. The overall decrease is primarily related to a decrease in trust and investment management fees and bank fees within non-interest income, partially offset by increases in net interest income driven by an increase in the average volume of our interest-earning assets and yield in the three months ended March 31, 2019 compared to the same period in 2018. During the three months ended March 31, 2019 average loans increased \$103.6 million and the yield on total interest-earning assets increased to 4.46% from 4.20%, compared to the same period in 2018.



## Capital Management

(Dollars in thousands)	As of and For the Three Months Ended March 31,		\$ Change	% Change
	2019	2018		
Total interest income	\$ —	\$ —	\$ —	—%
Total interest expense	—	—	—	—%
Provision for loan losses	—	—	—	—%
Net interest income	—	—	—	—%
Non-interest income	765	861	(96)	(11.1)%
Total income	765	861	(96)	(11.1)%
Depreciation and amortization expense	131	132	(1)	(0.8)%
All other non-interest expense	695	1,194	(499)	(41.8)%
Loss before income tax	(61)	(465)	404	(86.9)%
Goodwill	\$ 8,817	\$ 8,817	\$ —	—%
Identifiable assets	\$ 10,110	\$ 10,964	\$ (854)	(7.8)%

The Capital Management segment reported a loss before income tax of \$0.1 million for the three months ended March 31, 2019, compared to a loss of \$0.5 million for the same period in 2018. This was primarily driven by a decrease in other non-interest expense during the three months ended March 31, 2019 due to a reduction in salaries expense, office capacity, and professional fees compared to the same period in 2018. This reduction was correlated to an effort to align the cost structure of the segment with its revenues.

## Mortgage

(Dollars in thousands)	As of and For the Three Months Ended March 31,		\$ Change	% Change
	2019	2018		
Total interest income	\$ —	\$ —	\$ —	—%
Total interest expense	—	—	—	—%
Provision for loan losses	—	—	—	—%
Net interest income	—	—	—	—%
Non-interest income	1,479	1,267	212	16.7%
Total income	1,479	1,267	212	16.7%
Depreciation and amortization expense	65	104	(39)	(37.5)%
All other non-interest expense	1,313	1,397	(84)	(6.0)%
Income (loss) before income tax	101	(234)	335	(143.2)%
Goodwill	\$ —	\$ —	\$ —	—%
Identifiable assets	\$ 19,778	\$ 22,146	\$ (2,368)	(10.7)%

The Mortgage segment reported income before income tax of \$0.1 million for the three months ended March 31, 2019, compared to a loss of \$0.2 million, for the same period in 2018. The overall increase in non-interest income was primarily related to an increase in margins due to higher market rates partially offset by a decrease in the origination of mortgage loans sold for the three months ended March 31, 2019 compared to the same period in 2018. The decrease in other non-interest expense is a result of improvement in the cost structure within our Mortgage segment.

## Financial Condition

The table below presents our condensed consolidated balance sheets as of the dates presented:

<i>(Dollars in thousands)</i>	<b>March 31, 2019</b>	<b>December 31, 2018</b>	<b>\$ Change</b>	<b>% Change</b>
<b>Balance Sheet Data:</b>				
Cash and cash equivalents	\$ 69,766	\$ 73,357	\$ (3,591)	(4.9)%
Investments	53,610	43,695	9,915	22.7 %
Loans	931,190	893,966	37,224	4.2 %
Allowance for loan losses	(7,645)	(7,451)	(194)	2.6 %
Loans, net of allowance	923,545	886,515	37,030	4.2 %
Mortgage loans held for sale	19,778	14,832	4,946	33.3 %
Goodwill & intangibles, net	25,040	25,213	(173)	(0.7)%
Company-owned life insurance	14,803	14,709	94	0.6 %
Other assets	38,146	26,003	12,143	46.7 %
<b>Total assets</b>	<b>\$ 1,144,688</b>	<b>\$ 1,084,324</b>	<b>\$ 60,364</b>	<b>5.6 %</b>
Deposits	\$ 978,101	\$ 937,758	\$ 40,343	4.3 %
Borrowings	26,921	21,560	5,361	24.9 %
Other liabilities	19,998	8,131	11,867	145.9 %
<b>Total liabilities</b>	<b>1,025,020</b>	<b>967,449</b>	<b>57,571</b>	<b>6.0 %</b>
Total shareholders' equity	119,668	116,875	2,793	2.4 %
<b>Total liabilities and shareholders' equity</b>	<b>\$ 1,144,688</b>	<b>\$ 1,084,324</b>	<b>\$ 60,364</b>	<b>5.6 %</b>

Cash and cash equivalents decreased by \$3.6 million, or 4.9%, to \$69.8 million at March 31, 2019 compared to December 31, 2018. During the same period, investments increased by \$9.9 million, or 22.7%, to \$53.6 million at March 31, 2019. We continue to manage our balance sheet to ensure the amount of cash not being readily utilized is actively invested for optimal earnings.

Total loans increased by \$37.2 million, or 4.2%, from December 31, 2018 to \$931.2 million at March 31, 2019. The increase was primarily due to growth in our all major loan categories with the exception of commercial real estate.

Mortgage loans held for sale increased \$4.9 million, or 33.3%, to \$19.8 million at March 31, 2019 compared to December 31, 2018.

Goodwill and intangible assets, net decreased by \$0.2 million at March 31, 2019 compared to December 31, 2018 due to amortization on our intangible assets.

Our annual goodwill impairment assessment date for the Company's reporting units is October 31. Goodwill impairment testing may begin with an assessment of qualitative factors to determine whether certain circumstances or events exist that lead to a determination that the fair value of goodwill is less than the carrying value. This qualitative assessment includes various factors that could affect the reporting unit's fair value as well as mitigating events or conditions. The assessment of each reporting unit will compare the aggregate fair value to its carrying value, along with several valuation assumptions and methods in order to determine if any impairment was triggered as of the measurement date.

As of October 31, 2018 and December 31, 2018, the Company's enterprise market capitalization was trading below book value. We completed a "step 1" goodwill impairment test as of these dates and, based on the results of our assessment, we believed there were no reporting units at risk of failing "step 1" of the goodwill impairment test.

To estimate the fair value of our reporting units, we used an income approach, specifically a discounted cash flow methodology, and a market approach. The discounted cash flow methodology included assumptions for forecasted revenues, growth rates, discount rates, and market multiples, which all require significant judgment and estimates by management and are inherently uncertain. For the three months ending March 31, 2019, no negative events occurred that management considered to be an indicator of impairment that would require testing goodwill and indefinite lived intangible assets for impairment prior to our annual testing date.

Other assets increased by \$12.1 million, or 46.7%, from December 31, 2018 to \$38.1 million at March 31, 2019. This was primarily related to the addition of a right of use asset upon the adoption of ASU 2016-02 in 2019 classified in other assets on the consolidated balance sheet that was not on the consolidated balance sheet at December 31, 2018.

Total deposits increased \$40.3 million, or 4.3%, to \$978.1 million at March 31, 2019 compared to December 31, 2018. Total interest-bearing deposits increased \$16.7 million, or 2.3%, to \$751.6 million and noninterest-bearing deposits increased \$23.6 million, or 11.6%, to \$226.5 million, during this period.

Money market deposit accounts increased \$23.8 million, or 4.9%, to \$513.3 million at March 31, 2019 compared to December 31, 2018. Time deposit accounts decreased \$2.4 million, or 1.4%, from December 31, 2018 to \$176.3 million at March 31, 2019. Negotiable order of withdrawal, or NOW accounts, decreased \$5.4 million, or 8.3%, to \$59.5 million from December 31, 2018 to March 31, 2019. The increase in money market deposits was primarily attributed to an increase in organic growth related to our deposit initiatives as well as additional deposits added from our trust and investment management relationships for which we also provide deposit products. The decrease in time deposit accounts was primarily due to maturities and the decrease in NOW accounts was primarily due to client withdrawals for the three months ended March 31, 2019.

From December 31, 2018 to March 31, 2019 total borrowings increased \$5.4 million, or 24.9%, to \$26.9 million at March 31, 2019. The increase was attributable to an increase in our Federal Home Loan Bank (“FHLB”) line of credit at March 31, 2019 compared to December 31, 2018 due to normal liquidity needs of the Bank.

Total shareholders' equity increased \$2.8 million, or 2.4%, from December 31, 2018 to \$119.7 million at March 31, 2019. The increase is primarily due to \$0.4 million of stock-based compensation charges, net income of \$1.6 million, and a \$0.8 million decrease in the unrealized loss on our available-for-sale investments primarily due to changes in market rates.

## Assets Under Management

(Dollars in millions)	Three Months Ended	
	March 31, 2019	March 31, 2018
<b>Managed Trust Balance at Beginning of Period</b>	<b>\$ 1,380</b>	<b>\$ 1,438</b>
New relationships	30	2
Closed relationships	(1)	(2)
Contributions	3	15
Withdrawals	(78)	(84)
Market change, net	272	39
<b>Ending Balance</b>	<b>\$ 1,606</b>	<b>\$ 1,408</b>
Yield*	0.17 %	0.19 %
<b>Directed Trust Balance at Beginning of Period</b>	<b>\$ 789</b>	<b>\$ 714</b>
New relationships	9	37
Closed relationships	-	-
Contributions	2	3
Withdrawals	(3)	(3)
Market change, net	11	5
<b>Ending Balance</b>	<b>\$ 808</b>	<b>\$ 756</b>
Yield*	0.08 %	0.07 %
<b>Investment Agency Balance at Beginning of Period</b>	<b>\$ 1,846</b>	<b>\$ 2,100</b>
New relationships	6	21
Closed relationships	(23)	(107)
Contributions	44	51
Withdrawals	(66)	(80)
Market change, net	128	(11)
<b>Ending Balance</b>	<b>\$ 1,935</b>	<b>\$ 1,974</b>
Yield*	0.68 %	0.74 %
<b>Custody Balance at Beginning of Period</b>	<b>\$ 356</b>	<b>\$ 374</b>
New relationships	2	1
Closed relationships	(1)	-
Contributions	75	83
Withdrawals	(20)	(48)
Market change, net	60	11
<b>Ending Balance</b>	<b>\$ 472</b>	<b>\$ 421</b>
Yield*	0.03 %	0.04 %
<b>401(k)/Retirement Balance at Beginning of Period</b>	<b>\$ 864</b>	<b>\$ 748</b>
New relationships	6	52
Closed relationships	(22)	(21)
Contributions	29	24
Withdrawals	(21)	(15)
Market change, net	104	11
<b>Ending Balance</b>	<b>\$ 960</b>	<b>\$ 799</b>
Yield*	0.22 %	0.25 %
<b>Total Assets Under Management at Beginning of Period</b>	<b>5,235</b>	<b>5,374</b>
New relationships	53	113
Closed relationships	(47)	(130)
Contributions	153	176
Withdrawals	(188)	(230)
Market change, net	575	55
<b>Total Assets Under Management</b>	<b>\$ 5,781</b>	<b>\$ 5,358</b>
Yield*	0.32 %	0.37 %

\* Trust & investment management fees divided by period-end balance.

Assets under management increased \$546.1 million and decreased \$16.2 million, or 10.4% and 0.3% for the three months ended March 31, 2019 and 2018, respectively. The increase during the three months ended March 31, 2019 was primarily related to market gains. The decrease during the three month period ending March 31, 2018 was primarily related to withdrawals, partially offset by market gains. The decrease in yield for the three month period ended March 31, 2019 compared to March 31, 2018 is primarily related to a lower starting point of assets under management and market gains that occurred in the later portion of the three month period ended March 31, 2019.

### Available-for-sale securities

Investments we intend to hold for an indefinite period of time, but not necessarily to maturity, are classified as available-for-sale and are recorded at fair value using current market information from a pricing service, with unrealized gains and losses excluded from earnings and reported in other comprehensive income (loss), net of tax. All our investments

in securities were classified as available-for-sale for the periods presented below. The carrying values of our investment securities classified as available-for-sale are adjusted for unrealized gain or loss, and any gain or loss is reported on an after-tax basis as a component of other comprehensive income in shareholders' equity.

The following table summarizes the amortized cost and estimated fair value of our investment securities as of March 31, 2019:

	March 31, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<i>(Dollars in thousands)</i>				
Investment securities available-for-sale:				
U.S. Treasury debt	\$ 250	\$ 3	\$ —	\$ 253
Government National Mortgage Association mortgage-backed securities—residential (“GNMA”)	40,146	79	(802)	39,423
Federal National Mortgage Association mortgage-backed securities—residential (“FNMA”)	3,851	6	(111)	3,746
Securities issued by U.S. government sponsored entities and agencies	4,524	—	(124)	4,400
Corporate collateralized mortgage obligations (“CMO”) and mortgage-backed securities (“MBS”)	5,805	18	(35)	5,788
Total securities available-for-sale	\$ 54,576	\$ 106	\$ (1,072)	\$ 53,610

The following table summarizes the amortized cost and estimated fair value of our investment securities as of December 31, 2018:

	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<i>(Dollars in thousands)</i>				
Investment securities available-for-sale:				
U.S. Treasury debt	\$ 250	\$ —	\$ —	\$ 250
GNMA	35,591	8	(1,597)	34,002
FNMA	4,076	2	(208)	3,870
Securities issued by U.S. government sponsored entities and agencies	4,525	—	(223)	4,302
Corporate CMO and MBS	1,281	1	(11)	1,271
Total securities available-for-sale	\$ 45,723	\$ 11	\$ (2,039)	\$ 43,695

The following tables represent the book value of our contractual maturities and weighted average yield for our investment securities as of the dates presented. Contractual maturities may differ from expected maturities because issuers can have the right to call or prepay obligations without penalties. Our investments are taxable securities. Weighted average yields are not presented on a taxable equivalent basis.

	Maturity as of March 31, 2019							
	One Year or Less		One to Five Years		Five to Ten Years		After Ten Years	
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
<i>(Dollars in thousands)</i>								
Available-for-sale:								
U.S. Treasury debt	\$ —	— %	\$ 250	0.01 %	\$ —	— %	\$ —	— %
GNMA	—	—	—	—	—	—	40,146	1.87 %
FNMA	—	—	—	—	—	—	3,851	0.19 %
Securities issued by U.S. government sponsored entities and agencies	305	0.02	—	—	—	—	4,219	0.19 %
Corporate CMO and MBS	—	—	—	—	—	—	5,805	0.40 %
Total available-for-sale	\$ 305	0.02 %	\$ 250	0.01 %	\$ —	— %	\$ 54,021	2.65 %

	Maturity as of December 31, 2018							
	One Year or Less		One to Five Years		Five to Ten Years		After Ten Years	
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
<i>(Dollars in thousands)</i>								
Available-for-sale:								
U.S. Treasury debt	\$ —	— %	\$ 250	0.01 %	\$ —	— %	\$ —	— %
GNMA	—	—	—	—	—	—	35,591	1.90 %
FNMA	—	—	—	—	—	—	4,076	0.25 %
Securities issued by U.S. government sponsored entities and agencies	—	—	306	0.02	—	—	4,219	0.21 %
Corporate CMO and MBS	—	—	—	—	—	—	1,281	0.08 %
Total available-for-sale	\$ —	— %	\$ 556	0.03 %	\$ —	— %	\$ 45,167	2.44 %

At March 31, 2019 and December 31, 2018, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity.

### Loan Portfolio

Our primary source of interest income is derived through interest earned on loans to high net worth individuals, and their related commercial interests. Our senior lending and credit team consists of seasoned, experienced personnel and we believe that our officers are well versed in the types of lending in which we are engaged. Underwriting policies and decisions are managed centrally and the approval process is tiered based on loan size, making the process consistent, efficient and effective. The management team and credit culture demands prudent, practical, and conservative approaches to all credit requests in compliance with the loan policy guidelines to ensure strong credit underwriting practices.

In addition to originating loans for our own portfolio, we conduct mortgage banking activities in which we originate and sell, servicing-released, whole loans in the secondary market. Our mortgage banking loan sales activities are primarily directed at originating single family mortgages that are priced and underwritten to conform to previously agreed criteria before loan funding and are delivered to the investor shortly after funding. The level of future loan originations, loan sales and loan repayments depends on overall credit availability, the interest rate environment, the strength of the general economy, local real estate markets and the housing industry, and conditions in the secondary loan sale market. The amount of gain or loss on the sale of loans is primarily driven by market conditions and changes in interest rates, as well as our pricing and asset liability management strategies. As of March 31, 2019 and December 31, 2018, we had mortgage loans held for sale of \$19.8 million and \$14.8 million, respectively, in residential mortgage loans we originated.

The following table summarizes our loan portfolio by type of loan as of the dates indicated, in thousands:

	March 31,		December 31,	
	2019		2018	
	\$	%	\$	%
<i>(Dollars in thousands)</i>				
Cash, Securities and Other	\$ 130,641	14.0 %	\$ 114,165	12.8 %
Construction and Development	37,128	4.0 %	31,897	3.5 %
1 - 4 Family Residential	360,607	38.8 %	350,852	39.3 %
Non-Owner Occupied CRE	172,014	18.5 %	173,741	19.5 %
Owner Occupied CRE	108,873	11.7 %	108,480	12.2 %
Commercial and Industrial	120,602	13.0 %	113,660	12.7 %
Total loans held for investment <sup>(1)</sup>	\$ 929,865	100 %	\$ 892,795	100 %
Mortgage loans held for sale	\$ 19,778		\$ 14,832	

(1) Loans held for investment exclude deferred costs, net of \$1.3 million and \$1.2 million as of March 31, 2019 and December 31, 2018, respectively.

- *Cash, Securities and Other*—consists of consumer and commercial purpose loans that are primarily secured by securities managed and under custody with us, cash on deposit with us or life insurance policies. In addition, loans in this portfolio are collateralized with other sources of consumer collateral and an immaterial amount of each loan may be unsecured. This segment of our portfolio is affected by a variety of local and national economic factors affecting borrowers' employment prospects, income levels, and overall economic sentiment.

- *Construction and Development*—consists of loans to finance the construction of residential and non-residential properties. These loans are dependent on the strength of the industries of the related borrowers and the risks consistent with construction projects.
- *1-4 Family Residential*—consists of loans and home equity lines of credit secured by 1-4 family residential properties. These loans typically enable borrowers to purchase or refinance existing homes, most of which serve as the primary residence of the owner. In addition, some borrowers secure a commercial purpose loan with owner occupied or non-owner occupied 1-4 family residential properties. Loans in this segment are dependent on the industries tied to these loans as well as the national and local economies, and local residential and commercial real estate markets.
- *Commercial Real Estate, Owner Occupied and Non-Owner Occupied*—consists of commercial loans collateralized by real estate. These loans may be collateralized by owner occupied or non-owner occupied real estate, as well as multi-family residential real estate. These loans are dependent on the strength of the industries of the related borrowers and the success of their businesses.
- *Commercial and Industrial*—consists of commercial and industrial loans, including working capital lines of credit, permanent working capital term loans, business asset loans, acquisition, expansion and development loans, and other loan products, primarily in our target markets. This portfolio primarily consists of term loans and lines of credit which are dependent on the strength of the industries of the related borrowers and the success of their businesses.

The contractual maturity ranges of loans in our loan portfolio and the amount of such loans with fixed and floating interest rates in each maturity range, excluding deferred loan fees, as of the date indicated are summarized in the following tables:

	As of March 31, 2019			
	One Year or Less	One Through Five Years	After Five Years	Total
<i>(Dollars in thousands)</i>				
Cash, Securities and Other	\$ 2,889	\$ 115,203	\$ 12,549	\$ 130,641
Construction and Development	—	36,131	997	37,128
1 - 4 Family Residential	1,213	133,382	226,012	360,607
Non-Owner Occupied CRE	—	105,907	66,107	172,014
Owner Occupied CRE	—	37,631	71,242	108,873
Commercial and Industrial	2,015	95,738	22,849	120,602
Total loans	\$ 6,117	\$ 523,992	\$ 399,756	\$ 929,865
Amounts with fixed rates	\$ 3,402	\$ 279,015	\$ 158,190	\$ 440,607
Amounts with floating rates	2,715	244,977	241,566	489,258
Total loans	\$ 6,117	\$ 523,992	\$ 399,756	\$ 929,865

  

	As of December 31, 2018			
	One Year or Less	One Through Five Years	After Five Years	Total
<i>(Dollars in thousands)</i>				
Cash, Securities and Other	\$ 13,349	\$ 88,544	\$ 12,272	\$ 114,165
Construction and Development	—	31,162	735	31,897
1 - 4 Family Residential	1,217	142,853	206,782	350,852
Non-Owner Occupied CRE	1,398	100,486	71,857	173,741
Owner Occupied CRE	276	40,584	67,620	108,480
Commercial and Industrial	6,583	83,570	23,507	113,660
Total loans	\$ 22,823	\$ 487,199	\$ 382,773	\$ 892,795
Amounts with fixed rates	\$ 1,493	\$ 277,418	\$ 162,574	\$ 441,485
Amounts with floating rates	21,330	209,781	220,199	451,310
Total loans	\$ 22,823	\$ 487,199	\$ 382,773	\$ 892,795

## Non-Performing Assets

Non-performing assets include non-accrual loans, loans past due 90 days or more and still accruing interest, troubled debt restructurings (“TDRs”) still accruing interest, and other real estate owned (“OREO”). The accrual of interest on loans is discontinued at the time the loan becomes 90 or more days delinquent unless the loan is well secured and in the process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on non-accrual status or charged off if collection of interest or principal is considered doubtful.

OREO represents assets acquired through, or in lieu of, foreclosure. The amounts reported as OREO are supported by recent appraisals, with the appraised values adjusted, where applicable, for expected transaction fees likely to be incurred upon sale of the property. We incur recurring expenses relating to OREO in the form of maintenance, taxes, insurance and legal fees, among others, until the OREO parcel is disposed. While disposition efforts with respect to our OREO are generally ongoing, if these properties are appraised at lower-than-expected values or if we are unable to sell the properties at the prices for which we expect to be able to sell them, we may incur additional losses.

For the three months ended March 31, 2019 and 2018 the amount of lost interest for non-accrual loans was \$0.1 million and immaterial.

We had \$19.4 million in non-performing assets as of March 31, 2019 compared to \$19.7 million as of December 31, 2018. The \$0.3 million decrease in our non-performing assets was primarily related to a principle curtailment on a Commercial and Industrial loan for \$0.3 million and a payment received on a Cash, Securities, and Other loan for \$0.3 million, partially offset by an increase in another Commercial and Industrial loan due to an extension of credit for \$0.3 million to a borrower for operational needs driven by weather delays. As of March 31, 2019, these loans were classified as TDRs.

The following table presents information regarding non-performing loans as of the dates indicated:

(Dollars in thousands)	As of March 31,	As of December 31,
	2019	2018
Non-accrual loans by category		
Cash, Securities and Other	\$ 10,977	\$ 11,252
Construction and Development	—	—
1 - 4 Family Residential	—	—
Non-Owner Occupied CRE	—	—
Owner Occupied CRE	—	—
Commercial and Industrial	1,435	1,735
Total non-accrual loans	12,412	12,987
TDRs still accruing	5,088	4,848
Accruing loans 90 or more days past due	1,213	1,217
Total non-performing loans	18,713	19,052
OREO	658	658
Total non-performing assets	\$ 19,371	\$ 19,710
Ratio of non-performing loans to total loans <sup>(1)</sup>	2.01 %	2.13 %
Ratio of non-performing assets to total assets	1.69 %	1.82 %
Allowance as a percentage of non-performing loans	40.85 %	39.11 %

(1) Excludes mortgage loans held for sale of \$19.8 million and \$14.8 million as of March 31, 2019 and December 31, 2018, respectively.

## Potential Problem Loans

We categorize loans into risk categories based on relevant information about the ability of the borrowers to service their debt, such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. We analyze loans individually by classifying the loans as to credit risk on a quarterly basis, which are segregated into the following definitions for risk ratings:



**Special Mention**—Loans classified as special mention have a potential weakness or borrowing relationships that require more than the usual amount of management attention. Adverse industry conditions, deteriorating financial conditions, declining trends, management problems, documentation deficiencies or other similar weaknesses may be evident. Ability to meet current payment schedules may be questionable, even though interest and principal are still being paid as agreed. The asset has potential weaknesses that may result in deteriorating repayment prospects if left uncorrected. Loans in this risk grade are not considered adversely classified.

**Substandard**—Substandard loans are considered “classified” and are inadequately protected by the current net worth and paying capacity of the obligor or by the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardizes the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Loans in this category may be placed on non-accrual status and may individually be evaluated for impairment if indicators of impairment exist.

**Doubtful**—Loans graded Doubtful are considered “classified” and have all the weaknesses inherent in those classified as Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable. However, the amount or certainty of eventual loss is not known because of specific pending factors.

Loans not meeting any of the three criteria above are considered to be pass-rated loans.

As of March 31, 2019 and December 31, 2018 non-performing loans of \$18.7 million and \$19.1 million were included in the substandard category in the table below. The following tables present, by class and by credit quality indicator, the recorded investment in our loans as of the dates indicated:

(Dollars in thousands)	As of March 31, 2019				As of December 31, 2018			
	Pass	Special Mention	Substandard	Total	Pass	Special Mention	Substandard	Total
Cash, Securities and Other	\$ 119,664	\$ —	\$ 10,977	\$ 130,641	\$ 102,913	\$ —	\$ 11,252	\$ 114,165
Construction and Development	37,128	—	—	37,128	31,897	—	—	31,897
1 - 4 Family Residential	359,394	—	1,213	360,607	349,635	—	1,217	350,852
Non-Owner Occupied CRE	162,294	9,260	460	172,014	165,164	8,117	460	173,741
Owner Occupied CRE	108,873	—	—	108,873	108,480	—	—	108,480
Commercial and Industrial	108,082	—	12,520	120,602	100,929	—	12,731	113,660
Total	\$895,435	\$ 9,260	\$ 25,170	\$929,865	\$859,018	\$ 8,117	\$ 25,660	\$892,795

#### Allowance for Loan Losses

The allowance for loan losses is established through a provision for credit losses, which is a noncash charge to earnings. Loan losses are charged against the allowance when management believes the un-collectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance for loan losses.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and dollar volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral and prevailing economic conditions. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

The following table presents summary information regarding our allowance for loan losses for the periods indicated:

(Dollars in thousands)	As of and for the Three Months Ended March 31,	
	2019	2018
Average loans outstanding <sup>(1)(2)</sup>	\$ 915,921	\$ 812,306
Gross loans outstanding at end of period <sup>(3)</sup>	\$ 931,190	\$ 817,292
Allowance for loan losses at beginning of period	\$ 7,451	\$ 7,287
Provision for (recovery of) loan losses	194	(187)
Charge-offs:		
Cash, Securities and Other	—	—
Construction and Development	—	—
1 - 4 Family Residential	—	—
Non-Owner Occupied CRE	—	—
Owner Occupied CRE	—	—
Commercial and Industrial	—	—
Total charge-offs	—	—
Recoveries:		
Cash, Securities and Other	—	—
Construction and Development	—	—
1 - 4 Family Residential	—	—
Non-Owner Occupied CRE	—	—
Owner Occupied CRE	—	—
Commercial and Industrial	—	—
Total recoveries	—	—
Net charge-offs (recoveries)	—	—
Allowance for loan losses at end of period	\$ 7,645	\$ 7,100
Ratio of allowance to end of period loan	0.82 %	0.87 %
Ratio of net charge-offs to average loans <sup>(1)(4)</sup>	— %	— %

(1) Average balances are average daily balances.

(2) Excludes average outstanding balances of mortgage loans held for sale of \$13.3 million and \$18.4 million for the three months ended March 31, 2019 and 2018, respectively.

(3) Excludes mortgage loans held for sale of \$19.8 million and \$22.1 million as of March 31, 2019 and March 31, 2018, respectively.

(4) The ratio of net charge-offs to average loans is negligible or immaterial.

The following table represents the allocation of the allowance for loan losses among loan categories and other summary information. The allocation for loan losses by category should neither be interpreted as an indication of future charge-offs, nor as an indication that charge-offs in future periods will necessarily occur in these amounts or in the indicated proportions. The allocation of a portion of the allowance for loan losses to one category of loans does not preclude its availability to absorb losses in other categories.

(Dollars in thousands)	As of March 31,		As of December 31,	
	2019		2018	
	Amount	% <sup>(1)</sup>	Amount	% <sup>(1)</sup>
Cash, Securities and Other	\$ 877	14.0 %	\$ 764	12.8 %
Construction and development	266	4.0 %	232	3.5 %
1 - 4 Family Residential	2,588	38.8 %	2,552	39.3 %
Non-Owner Occupied CRE	1,235	18.5 %	1,264	19.5 %
Owner Occupied CRE	780	11.7 %	789	12.2 %
Commercial and Industrial	1,899	13.0 %	1,850	12.7 %
Total allowance for loan losses	\$ 7,645	100 %	\$ 7,451	100 %

(1) Represents the percentage of loans to total loans in the respective category.

## Deferred Tax Assets

Deferred tax assets represent the differences in timing of when items are recognized for GAAP purposes as opposed to tax purposes, as well as our net operating losses. As a result of the Tax Cuts and Jobs Act of 2017, our deferred tax assets are valued based on the amounts that are expected to be recovered in the future utilizing the tax rates in effect at the time recognized. As a result of book and tax basis differences, our deferred tax assets for the three months ended March 31, 2019 increased \$0.2 million from December 31, 2018.

## Deposits

Our deposit products include money market accounts, time-deposit accounts (typically certificates of deposit), NOW accounts (checking accounts), and saving accounts. Our accounts are federally insured by the FDIC up to the legal maximum.

Total deposits increased by \$40.3 million, or 4.3%, to \$978.1 million at March 31, 2019 from December 31, 2018. Total average deposits for the three months ended March 31, 2019 were \$980.9 million, an increase of \$170.8 million, or 21.1%, compared to \$810.1 million as of March 31, 2018. The increase in these periods is primarily due to our general deposit growth initiatives, the cross-selling of products, the skills of our sales and service team, as well as additional deposits added from our trust and investment management relationships for which we also provide deposit products. The increase in average rates in 2019 and 2018 was driven primarily by an increase in competition.

The following table presents the average balances and average rates paid on deposits for the periods below:

(Dollars in thousands)	As of and For the Three Month Period Ending			
	March 31,			
	2019	2018		
	Average Balance	Average Rate	Average Balance	Average Rate
<b>Deposits</b>				
Money market deposit accounts	\$519,251	1.62 %	\$323,206	0.81 %
Demand deposit accounts	60,550	0.20 %	75,400	0.14 %
Certificates and other time deposits > \$250k	80,706	1.71 %	78,624	0.82 %
Certificates and other time deposits < \$250k	97,845	1.77 %	116,120	1.29 %
Total time deposits	178,551	1.74 %	194,744	0.99 %
Savings accounts	2,155	0.10 %	1,798	0.12 %
Total interest-bearing deposits	760,507	1.53 %	595,148	0.78 %
Noninterest-bearing accounts	220,408		214,980	
Total deposits	<u>\$980,915</u>	1.19 %	<u>\$810,128</u>	0.57 %

Average noninterest-bearing deposits to average total deposits was 22.5% and 26.5% for the three months ended March 31, 2019 and 2018, respectively.

Our average cost of funds was 1.23% and 0.74% during the three months ended March 31, 2019 and 2018, respectively. The increase in our cost of funds for 2019 from 2018 was primarily due to an increase in our average rates on interest-bearing deposits to 1.53% during the three months ended March 31, 2019 compared to 0.78% for the three months ended March 31, 2018. This increase is primarily due to the impact of a rising rate environment and shift in deposit mix.

Total money market accounts as of March 31, 2019 were \$513.3 million, an increase of \$23.8 million, or 4.9%, compared to \$489.5 million as of December 31, 2018. Total time deposits as of March 31, 2019 were \$176.3 million, a decrease of \$2.4 million, or 1.4%, from December 31, 2018. The increase in money market deposits was primarily attributed to an increase in organic growth related to our deposit initiatives, partially offset by a reduction in brokered money market accounts. The decrease in time deposit accounts was primarily due to maturities for the three months ended March 31, 2019.

The following table represents the amount of certificates of deposit by time remaining until maturity as of March 31, 2019:

	As of March 31, 2019 Maturity Within:				
	Three Months or Less	Three to Six Months	Six to 12 Months	After 12 Months	Total
<i>(Dollars in thousands)</i>					
Time, \$250,000 and over	\$ 13,993	\$ 20,923	\$ 19,115	\$ 26,662	\$ 80,693
Other	38,979	10,138	33,782	12,720	95,619
Total	\$ 52,972	\$ 31,061	\$ 52,897	\$ 39,382	\$ 176,312

### Borrowings

We have short-term and long-term borrowing sources available to supplement deposits and meet our liquidity needs. As of March 31, 2019 and December 31, 2018, borrowings totaled \$26.9 million and \$21.6 million, respectively. The table below presents balances of each of the borrowing facilities as of the dates indicated:

<i>(Dollars in thousands)</i>	March 31, 2019	December 31, 2018
<b>Borrowings</b>		
FHLB Topeka borrowings	\$ 20,361	\$ 15,000
Subordinated notes	6,560	6,560
	\$ 26,921	\$ 21,560

*FHLB Topeka.* We have a blanket pledge and security agreement with the FHLB Topeka that requires certain loans and securities be pledged as collateral for any outstanding borrowings under the agreement. The collateral pledged as of March 31, 2019 and December 31, 2018 amounted to \$519.1 million and \$475.4 million, respectively. Based on this collateral and the Company's holdings of FHLB Topeka stock, the Company was eligible to borrow an additional \$331.6 million at March 31, 2019. As of March 31, 2019, the Company also had a note with FHLB Topeka of \$10.0 million, which is not included in the table below.

<i>(Dollars in thousands)</i>	As of and for the Year Ended March 31, 2019
<b>Short-term borrowings:</b>	
Maximum outstanding at any month-end during the period	\$ 10,361
Balance outstanding at end of period	\$ 10,361
Average outstanding during the period	\$ 401
Average interest rate during the period	2.64 %
Average interest rate at the end of the period	2.65 %

As of March 31, 2019 and December 31, 2018, we had three unsecured federal funds lines of credit with up to \$10.0 million, \$13.0 million, and \$25.0 million, respectively, available to us under such federal funds lines.

Our borrowing facilities include various financial and other covenants, including, but not limited to, a requirement that the Bank maintains regulatory capital that is deemed "well capitalized" by federal banking agencies. As of March 31, 2019 and December 31, 2018, the Company was in compliance with the covenant requirements.

### Liquidity and Capital Resources

Liquidity resources primarily include interest-bearing and noninterest-bearing deposits which primarily contribute to our ability to raise funds to support asset growth, acquisitions, and meet deposit withdrawals and other payment obligations. Access to purchased funds primarily include borrowing from FHLB Topeka and from correspondent banks.

The following table illustrates, during the periods presented, the composition of our funding sources and the average assets in which those funds are invested as a percentage of average total assets for the period indicated.

	Average Percentage for the Three-Month Period Ended March 31, 2019	Average Percentage for the Three-Month Period Ended March 31, 2018
<b>Sources of Funds:</b>		
Deposits:		
Noninterest-bearing	19.41 %	21.73 %
Interest-bearing	66.96 %	60.15 %
FHLB	0.92 %	5.61 %
Convertible subordinated debentures	— %	— %
Subordinated notes	0.58 %	1.36 %
Credit note	— %	— %
Other liabilities	1.70 %	0.70 %
Shareholders' equity	10.43 %	10.45 %
Total	100 %	100 %
<b>Uses of Funds:</b>		
Total loans	79.98 %	82.09 %
Available-for-sale securities	4.44 %	5.23 %
Mortgage loans held for sale	1.17 %	1.86 %
Promissory notes from related parties	— %	0.58 %
Interest-bearing deposits in other financial institutions	7.56 %	3.68 %
Noninterest-earning assets	6.85 %	6.56 %
Total	100 %	100 %
Average noninterest-bearing deposits to average deposits	22.47 %	26.54 %
Average loans to average deposits	93.37 %	100.27 %
Total interest-bearing deposits to total deposits	77.53 %	73.46 %

Our primary source of funds is interest-bearing and noninterest-bearing deposits, and our primary use of funds is loans and available-for-sale securities. We do not expect a change in the primary source or use of our funds in the foreseeable future.

#### *Capital Resources*

Total shareholders' equity increased \$2.8 million, or 2.4%, from December 31, 2018 to \$119.7 million at March 31, 2019. The increase is primarily due to \$0.4 million of stock-based compensation charges, net income of \$1.6 million, and a \$0.8 million decrease in the unrealized loss on our available-for-sale investments primarily due to changes in market rates.

We are subject to various regulatory capital adequacy requirements at a consolidated level and the bank level. These requirements are administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on our consolidated financial statements. Under capital adequacy guidelines and, additionally for banks, the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices.

Capital levels are viewed as important indicators of an institution's financial soundness by banking regulators. Generally, FDIC-insured depository institutions and their holding companies are required to maintain minimum capital relative to the amount and types of assets they hold. As of March 31, 2019 and December 31, 2018, our holding company and Bank exceeded the minimum capital levels required by their respective regulators. At March 31, 2019 and December 31, 2018, the Bank was classified as "well capitalized". As we continue to grow our operations and maintain capital requirements, our regulatory capital levels may decrease depending on our level of earnings. We continue to monitor growth and control our capital activities in order to remain in compliance with all applicable regulatory capital standards.

The following table presents our regulatory capital ratios for the dates noted.

(Dollars in thousands)	March 31, 2019		December 31, 2018	
	Amount	Ratio	Amount	Ratio
Common Equity Tier 1(CET1) to risk-weighted assets				
Bank	\$ 89,773	10.36 %	\$ 87,291	10.55 %
Consolidated Company	96,799	11.13 %	94,335	11.35 %
Tier 1 capital to risk-weighted assets				
Bank	89,773	10.36 %	87,291	10.55 %
Consolidated Company	96,799	11.13 %	94,335	11.35 %
Total capital to risk-weighted assets				
Bank	97,564	11.26 %	94,906	11.47 %
Consolidated Company	111,149	12.78 %	108,510	13.06 %
Tier 1 capital to average assets				
Bank	89,773	8.07 %	87,291	8.63 %
Consolidated Company	96,799	8.67 %	94,335	9.28 %

#### Contractual Obligations and Off-Balance Sheet Arrangements

We enter into credit-related financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. Commitments may expire without being utilized. Our exposure to credit loss is represented by the contractual amount of these commitments, although material losses are not anticipated. We follow the same credit policies in making commitments as we do for on-balance sheet instruments.

The following table presents future contractual obligations to make future payments with respect to borrowings for the periods indicated (amounts in thousands):

	As of March 31, 2019				
	1 Year or Less	More than 1 Year but Less than 3 Years	More than 3 Years but Less than 5 Years	5 Years or More	Total
FHLB Topeka	\$ 10,361	\$ 10,000	\$ —	\$ —	\$ 20,361
Subordinated notes	—	—	—	6,560 <sup>(1)</sup>	6,560
Total	\$ 10,361	\$ 10,000	\$ —	\$ 6,560	\$ 26,921

(1) Reflects a contractual maturity date of December 31, 2026.

The following tables present financial instruments whose contract amounts represent credit risk, as of the periods indicated.

	March 31, 2019		December 31, 2018	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Unused lines of credit	\$ 24,041	\$ 243,186	\$ 33,571	\$ 271,580
Standby letters of credit	\$ 65	\$ 23,508	\$ 40	\$ 23,508
Commitments to make loans to sell	\$ 42,237	\$ —	\$ 17,207	\$ —
Commitments to make loans	\$ 27,782	\$ 39,045	\$ 2,750	\$ 19,762

We may enter into contracts for services in the conduct of ordinary business operations, which may require payment for services to be provided in the future and may contain penalty clauses for early termination of the contracts. We do not believe these off-balance sheet arrangements have or are reasonably likely to have a material effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources. However, there can be no assurance that such arrangements will not have an effect on future operations.

## Critical Accounting Policies

Our accounting policies and procedures are described in Note 1 - Organization and Summary of Significant Accounting Policies in the accompanying Notes to the Consolidated Financial Statements

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

#### Interest Rate Sensitivity and Market Risk

Market risk is the risk of loss in a financial instrument arising from adverse changes in market prices and rates, foreign currency exchange rates, commodity prices and equity prices. Our market risk arises primarily from interest rate risk inherent in lending, investing and deposit taking activities. To that end, management actively monitors and manages interest rate risk exposure. We do not have any market risk sensitive instruments entered into for trading purposes.

Management uses various asset/liability strategies to manage the re-pricing characteristics of our assets and liabilities designed to ensure that exposure to interest rate fluctuations is limited within established guidelines of acceptable levels of risk-taking.

The board of directors monitors interest rate risk by analyzing the potential impact on the net economic value of equity and net interest income from potential changes in interest rates, and considers the impact of alternative strategies or changes in balance sheet structure. We manage our balance sheet in part to maintain the potential impact on economic value of equity and net interest income within acceptable ranges despite changes in interest rates.

Our exposure to interest rate risk is reviewed at least quarterly by the board of directors. Interest rate risk exposure is measured using interest rate sensitivity analysis to determine the change in economic value of equity in the event of hypothetical changes in interest rates. If potential changes to net economic value of equity and net interest income resulting from hypothetical interest rate changes are not within the limits established by our board of directors, the board of directors may direct management to adjust the asset and liability mix to bring interest rate risk within board-approved limits.

The following tables summarize the sensitivity in net interest income and fair value of equity over the periods indicated, using a parallel ramp scenario.

Change in Interest Rates (Basis Points)	As of March 31, 2019		As of December 31, 2018	
	Percent Change in Net Interest Income	Percent Change in Fair Value of Equity	Percent Change in Net Interest Income	Percent Change in Fair Value of Equity
300	(7.10)%	(14.34)%	(6.61)%	(16.14)%
200	(3.77)%	(6.79)%	(3.48)%	(8.18)%
100	(1.26)%	(1.84)%	(1.12)%	(2.69)%
Base	— %	— %	— %	— %
-100	1.63 %	(4.55)%	2.74 %	(0.02)%

The model simulations as of March 31, 2019 imply that our balance sheet remained liability sensitive compared to our balance sheet as of December 31, 2018.

Although the simulation model is useful in identifying potential exposure to interest rate changes, actual results for net interest income and economic value of equity may differ. There are a variety of factors that can impact the outcomes such as timing and magnitude of interest rate changes, asset and liability mix, pre-payment speeds, deposit beta assumptions, and decay rates that differ from our projections. Additionally, the results do not account for actions implemented to manage our interest rate risk exposure.

#### Impact of Inflation

Our consolidated financial statements and related notes included within this Form 10-Q have been prepared in accordance with GAAP, which requires the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative value of money over time due to inflation or recession.

Our assets and liabilities are substantially monetary in nature. Therefore, changes in interest rates can significantly impact on our performance beyond the general effects of inflation. Interest rates do not necessarily move in the same direction or magnitude as prices of general goods and services, while other operating expenses can be correlated with the impact of general levels of inflation.

#### **Item 4. Controls and Procedures**

##### *Evaluation of Disclosure Controls and Procedures*

As of the end of the period covered by this Form 10-Q, the Company carried out an evaluation, under the supervision and with the participation of its management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply judgment in evaluating its controls and procedures. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the "Exchange Act") were effective as of the end of the period covered by this report.

##### *Internal Control over Financial Reporting*

There were no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the three months ended March 31, 2019 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II. OTHER INFORMATION**

#### **Item 1. Legal Proceedings**

The Company, from time to time, is involved in various legal actions arising in the normal course of business. While the ultimate outcome of any such proceedings cannot be predicted with certainty, it is the opinion of management, based upon advice of legal counsel, that no proceedings exist, either individually or in the aggregate, which, if determined adversely to the Company, would have a material effect on the Company's consolidated financial statements. See Note 7 - Commitments and Contingencies in the Notes to Consolidated Financial Statements.

#### **Item 1A. Risk Factors**

There has been no material change in the risk factors previously disclosed under Item 1A of the Company in its' 2018 Annual Report on Form 10-K filed with the SEC, on March 21, 2019.

#### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

Not applicable.

#### **Item 3. Defaults upon Senior Securities**

Not applicable.

#### **Item 4. Mine Safety Disclosures**

Not applicable.

#### **Item 5. Other Information**

Not applicable.



**Item 6. Exhibits**

Exhibit No.	Description
10.1	<a href="#"><u>Amended Employment Agreement dated May 2, 2019, by and between First Western Financial, Inc. and Julie Courkamp, (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on May 8, 2019).</u></a>
10.2	<a href="#"><u>Ninth Amendment to Business Loan Agreement, dated March 18, 2019, by and between First Western Financial, Inc. and BMO Harris Bank N.A. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on March 22, 2019).</u></a>
31.1*	<a href="#"><u>Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u></a>
31.2*	<a href="#"><u>Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u></a>
32.1**	<a href="#"><u>Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u></a>
32.2**	<a href="#"><u>Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u></a>
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.

\* Filed herewith.

\*\* These exhibits are furnished herewith and shall not be deemed "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

### **First Western Financial, Inc.**

May 10, 2019  
Date

By: /s/ Scott C. Wylie  
Scott C. Wylie  
Chairman, Chief Executive Officer and President

May 10, 2019  
Date

By: /s/ Julie A. Courkamp  
Julie A. Courkamp  
Chief Financial Officer and Treasurer

**Certification of Chief Executive Officer  
Pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934  
and Section 302 of the Sarbanes-Oxley Act of 2002**

I, Scott C. Wylie, certify that:

1. I have reviewed this quarterly report on Form 10-Q of First Western Financial, Inc.:
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) [Paragraph omitted in accordance with Exchange Act Rule 13a-14(a)];
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this Report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 10, 2019

/s/ Scott C. Wylie

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Scott C. Wylie

Chairman, Chief Executive Officer and President  
(Principal Executive Officer)

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**Certification of Chief Financial Officer**  
**Pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934**  
**and Section 302 of the Sarbanes-Oxley Act of 2002**

I, Julie A. Courkamp, certify that:

1. I have reviewed this quarterly report on Form 10-Q of First Western Financial, Inc.:
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) [Paragraph omitted in accordance with Exchange Act Rule 13a-14(a)];
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this Report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 10, 2019

/s/ Julie A. Courkamp  
 Julie A. Courkamp  
 Chief Financial Officer and Treasurer  
 (Principal Financial Officer)

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CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with this report of First Western Financial, Inc. (the "Company") on Form 10-Q for the period ended March 31, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Scott C. Wylie, Chairman, Chief Executive Officer and President of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

FIRST WESTERN FINANCIAL, INC.

Date: May 10, 2019

/s/ Scott C. Wylie  
\_\_\_\_\_  
Scott C. Wylie  
Chairman, Chief Executive Officer and President

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CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with this report of First Western Financial, Inc. (the "Company") on Form 10-Q for the period ended March 31, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Julie A. Courkamp, Chief Financial Officer and Treasurer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

FIRST WESTERN FINANCIAL, INC.

Date: May 10, 2019

/s/ Julie A. Courkamp

Julie A. Courkamp

Chief Financial Officer and Treasurer

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