

**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 September 30, 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 001-38595

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

Colorado  
(State or other jurisdiction of  
incorporation or organization)

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

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

80202  
(Zip Code)

Registrant's telephone number, including area code: 303.531.8100

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

| Title of each class        | Trading Symbol | Name of each exchange on which registered |
|----------------------------|----------------|---|
| Common Stock, no par value | MYFW           | The Nasdaq Stock Market LLC               |

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 such files). ☒ Yes ☐ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company or an emerging growth company. See 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

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  
November 6, 2019  
7,986,128

**FIRST WESTERN FINANCIAL, INC.**  
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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 statement.

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

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

|  | September 30,<br>2019 | December 31,<br>2018 |
|--|-----------------------|----------------------|
| <b>ASSETS</b>  |                       |                      |
| Cash and cash equivalents:   |                       |                      |
| Cash and due from banks  | \$ 3,828              | \$ 1,574             |
| Interest-bearing deposits in other financial institutions  | 142,348               | 71,783               |
| Total cash and cash equivalents  | 146,176               | 73,357               |
| Available-for-sale securities  | 61,491                | 43,695               |
| Correspondent bank stock, at cost  | 582                   | 2,488                |
| Mortgage loans held for sale   | 69,231                | 14,832               |
| Loans, net of allowance of \$7,675 and \$7,451   | 918,911               | 886,515              |
| Premises and equipment, net  | 5,483                 | 6,100                |
| Accrued interest receivable  | 2,968                 | 2,844                |
| Accounts receivable  | 4,978                 | 4,492                |
| Other receivables  | 865                   | 1,391                |
| Other real estate owned, net   | 658                   | 658                  |
| Goodwill   | 19,686                | 24,811               |
| Other intangible assets, net   | 36                    | 402                  |
| Deferred tax assets, net   | 4,765                 | 4,306                |
| Company-owned life insurance   | 14,993                | 14,709               |
| Other assets   | 17,549                | 3,724                |
| Assets held for sale   | 3,553                 | —                    |
| Total assets   | \$ 1,271,925          | \$ 1,084,324         |
| <b>LIABILITIES</b>   |                       |                      |
| Deposits:  |                       |                      |
| Noninterest-bearing  | \$ 231,535            | \$ 202,856           |
| Interest-bearing   | 877,369               | 734,902              |
| Total deposits   | 1,108,904             | 937,758              |
| Borrowings:  |                       |                      |
| Federal Home Loan Bank Topeka borrowings   | 10,000                | 15,000               |
| Subordinated notes   | 6,560                 | 6,560                |
| Accrued interest payable   | 356                   | 231                  |
| Other liabilities  | 20,262                | 7,900                |
| Liabilities held for sale  | 111                   | —                    |
| Total liabilities  | 1,146,193             | 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; 7,983,284 and 7,968,420 shares issued and outstanding at September 30, 2019 and December 31, 2018, respectively | —                     | —                    |
| Additional paid-in capital   | 143,026               | 141,359              |
| Accumulated deficit  | (17,527)              | (23,199)             |
| Accumulated other comprehensive income (loss)  | 233                   | (1,285)              |
| Total shareholders' equity   | 125,732               | 116,875              |
| Total liabilities and shareholders' equity   | \$ 1,271,925          | \$ 1,084,324         |

See accompanying notes to condensed consolidated financial statements.

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

|  | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2019</b>                                 | <b>2018</b> | <b>2019</b>                                | <b>2018</b> |
| Interest and dividend income:  |   |             |  |             |
| Loans, including fees  | \$ 10,672                                   | \$ 9,468    | \$ 31,490                                  | \$ 27,144   |
| Investment securities  | 312   | 266         | 954  | 824         |
| Federal funds sold and other   | 489   | 206         | 1,254                                      | 483         |
| Total interest and dividend income                                   | 11,473                                      | 9,940       | 33,698                                     | 28,451      |
| Interest expense:  |   |             |  |             |
| Deposits   | 3,363                                       | 1,761       | 9,268                                      | 4,332       |
| Other borrowed funds   | 170   | 391         | 559  | 1,394       |
| Total interest expense   | 3,533                                       | 2,152       | 9,827                                      | 5,726       |
| Net interest income  | 7,940                                       | 7,788       | 23,871                                     | 22,725      |
| Less: provision for (recovery of) credit losses                      | 100   | 18          | 216  | (169)       |
| Net interest income, after provision for (recovery of) credit losses | 7,840                                       | 7,770       | 23,655                                     | 22,894      |
| Non-interest income:   |   |             |  |             |
| Trust and investment management fees                                 | 4,824                                       | 4,770       | 14,186                                     | 14,413      |
| Net gain on mortgage loans sold                                      | 3,291                                       | 1,159       | 8,009                                      | 3,769       |
| Bank fees  | 283   | 361         | 912  | 1,426       |
| Risk management and insurance fees                                   | 176   | 249         | 838  | 916         |
| Net gain on sale of securities                                       | 119   | —           | 119  | —           |
| Income on company-owned life insurance                               | 95  | 99          | 284  | 298         |
| Total non-interest income  | 8,788                                       | 6,638       | 24,348                                     | 20,822      |
| Total income before non-interest expense                             | 16,628                                      | 14,408      | 48,003                                     | 43,716      |
| Non-interest expense:  |   |             |  |             |
| Salaries and employee benefits                                       | 8,504                                       | 7,221       | 23,821                                     | 23,061      |
| Occupancy and equipment  | 1,388                                       | 1,427       | 4,193                                      | 4,439       |
| Professional services  | 745   | 805         | 2,557                                      | 2,637       |
| Technology and information systems                                   | 961   | 965         | 3,046                                      | 3,028       |
| Data processing  | 854   | 697         | 2,282                                      | 2,024       |
| Marketing  | 272   | 274         | 991  | 875         |
| Amortization of other intangible assets                              | 52  | 208         | 366  | 668         |
| Goodwill impairment  | —   | —           | 1,572                                      | —           |
| Other  | 666   | 579         | 1,873                                      | 1,814       |
| Total non-interest expense   | 13,442                                      | 12,176      | 40,701                                     | 38,546      |
| Income before income taxes   | 3,186                                       | 2,232       | 7,302                                      | 5,170       |
| Income tax expense   | 780   | 543         | 1,865                                      | 1,247       |
| Net income   | 2,406                                       | 1,689       | 5,437                                      | 3,923       |
| Preferred stock dividends  | —   | (255)       | —  | (1,378)     |
| Net income available to common shareholders                          | \$ 2,406                                    | \$ 1,434    | \$ 5,437                                   | \$ 2,545    |
| Earnings per common share:   |   |             |  |             |
| Basic  | \$ 0.30                                     | \$ 0.19     | \$ 0.69                                    | \$ 0.40     |
| Diluted  | \$ 0.30                                     | \$ 0.19     | \$ 0.69                                    | \$ 0.40     |

See accompanying notes to condensed consolidated financial statements.

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

|  | <u>Three Months Ended September 30,</u> |             | <u>Nine Months Ended September 30,</u> |             |
|--|---|-------------|--|-------------|
|  | <u>2019</u>                             | <u>2018</u> | <u>2019</u>                            | <u>2018</u> |
| Net income   | \$ 2,406                                | \$ 1,689    | \$ 5,437                               | \$ 3,923    |
| Other comprehensive income (loss) items:                                 |   |             |  |             |
| Net change in unrealized gains (losses) on available-for-sale securities | 321                                     | (373)       | 2,364                                  | (1,219)     |
| Income tax effects   | (83)                                    | 136         | (611)                                  | 309         |
| Total other comprehensive income (loss)                                  | 238                                     | (237)       | 1,753                                  | (910)       |
| Comprehensive income   | \$ 2,644                                | \$ 1,452    | \$ 7,190                               | \$ 3,013    |

See accompanying notes to condensed consolidated financial statements.



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

|   | Preferred<br>Stock | Shares<br>Convertible<br>Preferred<br>Stock | Common<br>Stock | Additional<br>Paid-In<br>Capital | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total      |
|---|--------------------|---|-----------------|----------------------------------|------------------------|--|------------|
| Balance at July 1, 2018   | 20,868             | 41,000                                      | 5,917,667       | \$ 132,785                       | \$ (26,226)            | \$ (1,601)   | \$ 104,958 |
| Net income  | —                  | —   | —               | —                                | 1,689                  | —  | 1,689      |
| Issuance of common stock, net of issuance costs                   | —                  | —   | 1,921,775       | 32,541                           | —                      | —  | 32,541     |
| Make whole share issuance   | —                  | —   | 128,978         | —                                | —                      | —  | —          |
| Preferred stock Series A-C redemption                             | (20,868)           | —   | —               | (20,783)                         | (85)                   | —  | (20,868)   |
| Preferred stock Series D redemption                               | —                  | (41,000)                                    | —               | (4,054)                          | (46)                   | —  | (4,100)    |
| Other comprehensive loss, net of tax                              | —                  | —   | —               | —                                | —                      | (237)  | (237)      |
| Stock-based compensation  | —                  | —   | —               | 436                              | —                      | —  | 436        |
| Preferred stock dividends   | —                  | —   | —               | —                                | (255)                  | —  | (255)      |
| Balance at September 30, 2018                                     | —                  | —   | 7,968,420       | \$ 140,925                       | \$ (24,923)            | \$ (1,838)   | \$ 114,164 |
| Balance at July 1, 2019   | —                  | —   | 7,983,866       | \$ 142,095                       | \$ (19,933)            | \$ (5)   | \$ 122,157 |
| Net income  | —                  | —   | —               | —                                | 2,406                  | —  | 2,406      |
| Share repurchase  | —                  | —   | (582)           | (8)                              | —                      | —  | (8)        |
| Other comprehensive income, net of tax                            | —                  | —   | —               | —                                | —                      | 238  | 238        |
| Stock-based compensation  | —                  | —   | —               | 939                              | —                      | —  | 939        |
| Balance at September 30, 2019                                     | —                  | —   | 7,983,284       | \$ 143,026                       | \$ (17,527)            | \$ 233   | \$ 125,732 |
| Balance at January 1, 2018  | 20,868             | 41,000                                      | 5,833,456       | \$ 130,070                       | \$ (27,296)            | \$ (928)   | \$ 101,846 |
| Net income  | —                  | —   | —               | —                                | 3,923                  | —  | 3,923      |
| Issuance of common stock, net of issuance costs of \$4,411        | —                  | —   | 1,989,017       | 34,450                           | —                      | —  | 34,450     |
| Make whole share issuance   | —                  | —   | 128,978         | —                                | —                      | —  | —          |
| Preferred stock Series A-C redemption                             | (20,868)           | —   | —               | (20,783)                         | (85)                   | —  | (20,868)   |
| Preferred stock Series D redemption                               | —                  | (41,000)                                    | —               | (4,054)                          | (46)                   | —  | (4,100)    |
| Other comprehensive loss, net of tax                              | —                  | —   | —               | —                                | —                      | (951)  | (951)      |
| Settlement of share awards  | —                  | —   | 16,969          | (181)                            | —                      | —  | (181)      |
| Reclassification on unrealized loss on equity securities          | —                  | —   | —               | —                                | (41)                   | 41   | —          |
| Stock-based compensation  | —                  | —   | —               | 1,423                            | —                      | —  | 1,423      |
| Preferred stock dividends   | —                  | —   | —               | —                                | (1,378)                | —  | (1,378)    |
| Balance at September 30, 2018                                     | —                  | —   | 7,968,420       | \$ 140,925                       | \$ (24,923)            | \$ (1,838)   | \$ 114,164 |
| Balance at January 1, 2019  | —                  | —   | 7,968,420       | \$ 141,359                       | \$ (23,199)            | \$ (1,285)   | \$ 116,875 |
| Net income  | —                  | —   | —               | —                                | 5,437                  | —  | 5,437      |
| Settlement of share awards  | —                  | —   | 15,446          | (110)                            | —                      | —  | (110)      |
| Adoption of ASU 2018-02 - Reclassification of stranded tax effect | —                  | —   | —               | —                                | 235                    | (235)  | —          |
| Stock repurchase  | —                  | —   | (582)           | (8)                              | —                      | —  | (8)        |
| Other comprehensive income, net of tax                            | —                  | —   | —               | —                                | —                      | 1,753  | 1,753      |
| Stock-based compensation  | —                  | —   | —               | 1,785                            | —                      | —  | 1,785      |
| Balance at September 30, 2019                                     | —                  | —   | 7,983,284       | \$ 143,026                       | \$ (17,527)            | \$ 233   | \$ 125,732 |

See accompanying notes to condensed consolidated financial statements.

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

|   | Nine Months Ended September 30, |                  |
|---|---------------------------------|------------------|
|   | 2019                            | 2018             |
| <b>Cash flows from operating activities</b>                                       |                                 |                  |
| Net income  | \$ 5,437                        | \$ 3,923         |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                 |                  |
| Depreciation and amortization   | 1,363                           | 1,707            |
| Deferred income tax expense   | 218                             | 1,361            |
| Stock-based compensation  | 1,785                           | 1,423            |
| Provision for (recovery of) credit losses   | 216                             | (169)            |
| Net amortization of investment securities   | 118                             | 150              |
| Change in fair value of equity securities   | —                               | 11               |
| Stock dividends received on correspondent bank stock                              | (25)                            | (111)            |
| Increase in cash surrender value of company-owned life insurance                  | (284)                           | (298)            |
| Net gain on mortgage loans sold   | (8,009)                         | (3,769)          |
| Origination of mortgage loans held for sale                                       | (501,312)                       | (364,962)        |
| Proceeds from mortgage loans sold   | 452,601                         | 372,298          |
| Proceeds from sale of securities  | (119)                           | —                |
| Loss on impairment of goodwill  | 1,572                           | —                |
| Net changes in operating assets and liabilities:                                  |                                 |                  |
| Accounts receivable   | (486)                           | 856              |
| Accrued interest receivable and other assets                                      | (81)                            | (1,731)          |
| Accrued interest payable and other liabilities                                    | 727                             | (2,132)          |
| Net cash used in operating activities   | (46,279)                        | 8,557            |
| <b>Cash flows from investing activities</b>                                       |                                 |                  |
| Activity in available-for-sale securities:  |                                 |                  |
| Maturities, prepayments, and calls  | 6,202                           | 11,663           |
| Sales   | 7,506                           | 250              |
| Purchases   | (29,750)                        | (250)            |
| Purchases of correspondent bank stock   | (1,237)                         | (726)            |
| Redemption of correspondent bank stock  | 3,168                           | —                |
| Purchases of premises and equipment   | (380)                           | (525)            |
| Payments received on promissory notes from related parties                        | —                               | 3,701            |
| Loan and note receivable originations and principal collections, net              | (32,439)                        | (41,359)         |
| Net cash used in investing activities   | (46,930)                        | (27,246)         |
| <b>Cash flows from financing activities</b>                                       |                                 |                  |
| Net change in deposits  | 171,146                         | 62,522           |
| Payments on Subordinated Notes  | —                               | (6,875)          |
| Proceeds from issuance of common stock, net                                       | —                               | 34,450           |
| Repurchase of common stock  | (8)                             | —                |
| Settlement of restricted stock  | (110)                           | (181)            |
| Dividends paid on preferred stock   | —                               | (1,378)          |
| Redemption of preferred stock Series A-C  | —                               | (20,783)         |
| Redemption of preferred stock Series D  | —                               | (4,054)          |
| Redemption costs  | —                               | (131)            |
| Payments to Federal Home Loan Bank Topeka borrowings                              | (72,346)                        | (188,200)        |
| Proceeds from Federal Home Loan Bank Topeka borrowings                            | 67,346                          | 204,235          |
| Net cash provided by financing activities   | 166,028                         | 79,605           |
| Net change in cash and cash equivalents   | 72,819                          | 60,916           |
| Cash and cash equivalents, beginning of year                                      | 73,357                          | 9,502            |
| <b>Cash and cash equivalents, end of period</b>                                   | <b>\$ 146,176</b>               | <b>\$ 70,418</b> |
| <b>Supplemental cash flow information:</b>  |                                 |                  |
| Interest paid on deposits and borrowed funds                                      | \$ 9,702                        | \$ 5,712         |
| Income tax payment, net of refunds received                                       | 1,562                           | 552              |
| Cash paid for amounts included in the measurement of lease liabilities            | 4,091                           | —                |
| <b>Supplemental noncash disclosures:</b>  |                                 |                  |
| Reclass of promissory note to loans   | —                               | 2,134            |
| Available-for-sale reclass of equity securities                                   | —                               | 703              |
| Adoption of ASU 2018-02 - Reclassification of stranded tax effects                | 235                             | —                |
| Reclass of unrealized loss on equity securities                                   | —                               | 52               |
| Lease right-of-use-asset obtained in exchange for lease liabilities               | 16,580                          | —                |
| Reclass of held for sale assets net of liabilities                                | 3,442                           | —                |

See accompanying notes to condensed consolidated financial statements.

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

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

**Business and Basis of Presentation:** The condensed 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, Fort Collins and Vail Valley), 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 condensed 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 condensed 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 and nine months ended September 30, 2019 are not necessarily indicative of results that may be expected for the full year ending December 31, 2019. In preparing the condensed 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 condensed 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 September 30, 2019 and December 31, 2018, 71.5%, 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 and nine months ended September 30, 2019 and the year ended December 31, 2018 were immaterial. Receivables are recorded on the condensed 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 condensed consolidated statement of operations for the three and nine months ended September 30, 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 5 – 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 reflects a pending pronouncement with an update 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 and the allowance for loan losses as of the beginning of the first reporting period in which the guidance is effective. ASU 2016-13 will be effective for most public companies on January 1, 2020.

On July 17, 2019, the FASB voted to delay CECL implementation for certain companies including smaller reporting companies ("SRCs") as defined by the SEC. The Company is designated as a SRC with the SEC. The proposed delay by FASB was subject to a comment period. At the October 16, 2019 FASB meeting, the FASB voted unanimously to delay the effective date of CECL adoption for SRCs to January 1, 2023. The proposal approved by the FASB on October 16<sup>th</sup> has led to the creation of a framework for future standard setting where two "buckets" are used, allowing at least a two-year difference in the effective dates for major standards. The "buckets" the FASB proposed are SEC filers other than SRCs and all other companies including SRCs. The final amendment is expected later in 2019.

During the three months ended September 30, 2019, the CECL committee of the Company continued to work through its implementation plan. The Company has integrated historical and current loan level data as required by CECL and is working with its third-party vendor solution to begin evaluating the methodologies available under the CECL model on its loan portfolios. The Company also continues to evaluate documentation requirements, internal control structure, relevant data sources, and system configurations. The Company has completed a successful integration of the required fields and historical data for key loan, customer and collateral data within the third-party solution and has been able to run parallels of our current ALLL calculation in the software to compare to our internal calculation and reconcile known differences. 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. The Company expects to implement the new standard beginning January 1, 2023.

## 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 September 30, 2019 and December 31, 2018 (in thousands):

|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value    |
|--|-------------------|------------------------------|-------------------------------|------------------|
| <b>September 30, 2019</b>  |                   |                              |                               |                  |
| Investment securities available-for-sale:  |                   |                              |                               |                  |
| U.S. Treasury debt   | \$ 250            | \$ 5                         | \$ —                          | \$ 255           |
| Government National Mortgage Association mortgage-backed securities—residential (“GNMA”)     | 45,439            | 389                          | (93)                          | 45,735           |
| Federal National Mortgage Association mortgage-backed securities—residential (“FNMA”)        | 3,326             | 10                           | (27)                          | 3,309            |
| Securities issued by U.S. government sponsored entities and agencies                         | —                 | —                            | —                             | —                |
| Corporate collateralized mortgage obligations (“CMO”) and mortgage-backed securities (“MBS”) | 12,140            | 77                           | (25)                          | 12,192           |
| Total securities available-for-sale  | <u>\$ 61,155</u>  | <u>\$ 481</u>                | <u>\$ (145)</u>               | <u>\$ 61,491</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 September 30, 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<br>Cost | Fair<br>Value    |
|--|-------------------|------------------|
| <b>September 30, 2019</b>              |                   |                  |
| Due within one year through five years | \$ 250            | \$ 255           |
| Securities (agency and CMO)            | 60,905            | 61,236           |
| Total                                  | <u>\$ 61,155</u>  | <u>\$ 61,491</u> |

At September 30, 2019 and December 31, 2018, securities with carrying values totaling \$5.9 million and \$5.4 million, respectively, were pledged to secure various public deposits and credit facilities of the Company.

At September 30, 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 September 30, 2019 and December 31, 2018, ten securities and thirty-three securities, respectively were in an unrealized loss position, with unrealized losses totaling \$0.1 million and \$2.0 million, respectively. Three of the securities in an unrealized loss position at September 30, 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 twelve 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 September 30, 2019.

The following table summarizes securities with unrealized losses at September 30, 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>September 30, 2019</b>  |                     |                   |                     |                   |            |                   |
| U.S. Treasury debt   | \$ —                | \$ —              | \$ —                | \$ —              | \$ —       | \$ —              |
| GNMA   | 1,439               | (5)               | 4,584               | (88)              | 6,023      | (93)              |
| FNMA   | —                   | —                 | 2,737               | (27)              | 2,737      | (27)              |
| Corporate CMO and MBS  | 7,995               | (25)              | —                   | —                 | 7,995      | (25)              |
| Total  | \$ 9,434            | \$ (30)           | \$ 7,321            | \$ (115)          | \$ 16,755  | \$ (145)          |
| <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 sold \$7.5 million of securities and realized \$0.1 million of gains, from the sale of securities using the specific identification method for the three and nine months ended September 30, 2019. The Company did not sell any securities during the three and nine months ended September 30, 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):

|                              | September 30, 2019 | December 31, 2018 |
|------------------------------|--------------------|-------------------|
| Cash, Securities and Other   | \$ 146,622         | \$ 114,165        |
| Construction and Development | 42,059             | 31,897            |
| 1-4 Family Residential       | 366,238            | 350,852           |
| Non-Owner Occupied CRE       | 138,753            | 173,741           |
| Owner Occupied CRE           | 119,497            | 108,480           |
| Commercial and Industrial    | 111,187            | 113,660           |
| Total loans                  | 924,356            | 892,795           |
| Deferred costs, net          | 2,230              | 1,171             |
| Allowance for loan losses    | (7,675)            | (7,451)           |
| Loans, net                   | \$ 918,911         | \$ 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 September 30, 2019 and December 31, 2018 (in thousands):

|                              | 30-59<br>Days<br>Past Due | 60-89<br>Days<br>Past Due | 90 or<br>More Days<br>Past Due | Total<br>Loans<br>Past Due | Current           | Total<br>Recorded<br>Investment |
|------------------------------|---------------------------|---------------------------|--------------------------------|----------------------------|-------------------|---------------------------------|
| <b>September 30, 2019</b>    |                           |                           |                                |                            |                   |                                 |
| Cash, Securities and Other   | \$ 339                    | \$ —                      | \$ —                           | \$ 339                     | \$ 146,283        | \$ 146,622                      |
| Construction and Development | —                         | —                         | —                              | —                          | 42,059            | 42,059                          |
| 1-4 Family Residential       | —                         | —                         | 1,213                          | 1,213                      | 365,025           | 366,238                         |
| Non-Owner Occupied CRE       | 902                       | —                         | —                              | 902                        | 137,851           | 138,753                         |
| Owner Occupied CRE           | —                         | —                         | —                              | —                          | 119,497           | 119,497                         |
| Commercial and Industrial    | 4,599                     | —                         | —                              | 4,599                      | 106,588           | 111,187                         |
| <b>Total</b>                 | <b>\$ 5,840</b>           | <b>\$ —</b>               | <b>\$ 1,213</b>                | <b>\$ 7,053</b>            | <b>\$ 917,303</b> | <b>\$ 924,356</b>               |
|                              |                           |                           |                                |                            |                   |                                 |
| <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 September 30, 2019 and December 31, 2018, the Company had a 1-4 Family Residential loan totaling \$1.2 million, which was more than 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):

|                              | September 30,<br>2019 | December 31,<br>2018 |
|------------------------------|-----------------------|----------------------|
| Cash, Securities and Other   | \$ 5,264              | \$ 11,252            |
| Construction and Development | —                     | —                    |
| 1-4 Family Residential       | —                     | —                    |
| Non-Owner Occupied CRE       | —                     | —                    |
| Owner Occupied CRE           | —                     | —                    |
| Commercial and Industrial    | 1,035                 | 1,735                |
| <b>Total</b>                 | <b>\$ 6,299</b>       | <b>\$ 12,987</b>     |

Non-accrual loans classified as TDR accounted for \$6.1 million of the recorded investment at September 30, 2019 and \$13.0 million at December 31, 2018, respectively. Non-accrual loans are classified as impaired loans and individually evaluated for impairment.

The following presents a summary of the unpaid principal balance of loans classified as TDRs by loan type and delinquency status as of the dates noted (in thousands):

|   | September 30,<br>2019 | December 31,<br>2018 | September 30,<br>2018 |
|---|-----------------------|----------------------|-----------------------|
| <b>Accruing</b>                               |                       |                      |                       |
| Commercial and Industrial                     | \$ 6,468              | \$ 4,848             | \$ —                  |
| <b>Nonaccrual</b>                             |                       |                      |                       |
| Cash, Securities, and Other                   | 5,017                 | 11,252               | —                     |
| Commercial and Industrial                     | 1,035                 | 1,735                | 1,835                 |
| <b>Allowance for loan associated with TDR</b> | <b>(693)</b>          | <b>(940)</b>         | <b>(1,040)</b>        |
| Net recorded investment                       | <u>\$ 11,827</u>      | <u>\$ 16,895</u>     | <u>\$ 795</u>         |

At September 30, 2019, the Company extended an additional \$1.0 million to a Commercial and Industrial borrower with a loan classified as a TDR for operational needs as allowed under the commitment. 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.

One Cash, Securities and Other loan, which was modified resulting in TDR status in the previous twelve months, has defaulted on the modified terms of the agreement one time in the three and nine months ended September 30, 2019.

The Company did not modify any loans into a TDR for the three and nine months ended September 30, 2019. The Company modified two loans into a TDR for the year ended December 31, 2018. The modification of two loans in TDR performed during the year ended December 31, 2018 included an extension of the maturity dates at the same rates as before that the Company would not have otherwise considered as a result of the Borrowers' financial difficulties. The extensions on the modified loans ranged from three months to a year.

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 table presents impaired loans by portfolio and related valuation allowance as of the periods presented (in thousands):

|  | September 30, 2019              |   |                                    | December 31, 2018               |   |                                    |
|--|---------------------------------|---|------------------------------------|---------------------------------|---|------------------------------------|
|  | Total<br>Recorded<br>Investment | Unpaid<br>Contractual<br>Principal<br>Balance | Allowance<br>for<br>Loan<br>Losses | Total<br>Recorded<br>Investment | Unpaid<br>Contractual<br>Principal<br>Balance | Allowance<br>for<br>Loan<br>Losses |
| <b>Impaired loans with a valuation allowance:</b>          |                                 |   |                                    |                                 |   |                                    |
| Commercial and Industrial                                  | \$ 1,035                        | \$ 1,035                                      | \$ 693                             | \$ 1,735                        | \$ 1,735                                      | \$ 940                             |
| Cash, Securities, and Other                                | 247                             | 247   | 247                                | —                               | —   | —                                  |
| Total  | <u>\$ 1,282</u>                 | <u>\$ 1,282</u>                               | <u>\$ 940</u>                      | <u>\$ 1,735</u>                 | <u>\$ 1,735</u>                               | <u>\$ 940</u>                      |
| <b>Impaired loans with no related valuation allowance:</b> |                                 |   |                                    |                                 |   |                                    |
| Commercial and Industrial                                  | \$ 6,468                        | \$ 6,468                                      | \$ —                               | \$ 4,848                        | \$ 4,848                                      | \$ —                               |
| Cash, Securities, and Other                                | 5,017                           | 5,017   | —                                  | 11,252                          | 11,252  | —                                  |
| 1-4 Family Residential                                     | 1,213                           | 1,213   | —                                  | —                               | —   | —                                  |
| Total  | <u>\$ 12,698</u>                | <u>\$ 12,698</u>                              | <u>\$ —</u>                        | <u>\$ 16,100</u>                | <u>\$ 16,100</u>                              | <u>\$ —</u>                        |
| <b>Total impaired loans:</b>                               |                                 |   |                                    |                                 |   |                                    |
| Commercial and Industrial                                  | \$ 7,503                        | \$ 7,503                                      | \$ 693                             | \$ 6,583                        | \$ 6,583                                      | \$ 940                             |
| Cash, Securities, and Other                                | 5,264                           | 5,264   | 247                                | 11,252                          | 11,252  | —                                  |
| 1-4 Family Residential                                     | 1,213                           | 1,213   | —                                  | —                               | —   | —                                  |
| Total  | <u>\$ 13,980</u>                | <u>\$ 13,980</u>                              | <u>\$ 940</u>                      | <u>\$ 17,835</u>                | <u>\$ 17,835</u>                              | <u>\$ 940</u>                      |

The recorded investment in loans in the previous tables excludes accrued interest and deferred loan fees and costs which are not material. Interest income, if any, was recognized on the cash basis on non-accrual loans.

The average balance of impaired loans and interest income recognized on impaired loans during the three months ended September 30, 2019 and 2018 are included in the table below (in thousands):



|  | Three Months Ended September 30,  |                                  |                                   |                                  |
|--|-----------------------------------|----------------------------------|-----------------------------------|----------------------------------|
|  | 2019                              |                                  | 2018                              |                                  |
|  | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| <b>Impaired loans with a valuation allowance:</b>          |                                   |                                  |                                   |                                  |
| Commercial and Industrial                                  | \$ 1,035                          | \$ —                             | \$ 1,835                          | \$ —                             |
| Cash, Securities, and Other                                | 185                               | —                                | —                                 | —                                |
| Total  | <u>\$ 1,220</u>                   | <u>\$ —</u>                      | <u>\$ 1,835</u>                   | <u>\$ —</u>                      |
| <b>Impaired loans with no related valuation allowance:</b> |                                   |                                  |                                   |                                  |
| Commercial and Industrial                                  | \$ 5,958                          | \$ 138                           | \$ —                              | \$ —                             |
| Cash, Securities, and Other                                | 5,062                             | —                                | 11,277                            | —                                |
| 1-4 Family Residential                                     | 1,213                             | 26                               | —                                 | —                                |
| Total  | <u>\$ 12,233</u>                  | <u>\$ 164</u>                    | <u>\$ 11,277</u>                  | <u>\$ —</u>                      |
| <b>Total impaired loans:</b>                               |                                   |                                  |                                   |                                  |
| Commercial and Industrial                                  | \$ 6,993                          | \$ 138                           | \$ 1,835                          | \$ —                             |
| Cash, Securities, and Other                                | 5,247                             | —                                | 11,277                            | —                                |
| 1-4 Family Residential                                     | 1,213                             | 26                               | —                                 | —                                |
| Total  | <u>\$ 13,453</u>                  | <u>\$ 164</u>                    | <u>\$ 13,112</u>                  | <u>\$ —</u>                      |

The average balance of impaired loans and interest income recognized on impaired loans during the nine months ended September 30, 2019 and 2018 are included in the table below (in thousands):

|  | Nine Months Ended September 30,   |                                  |                                   |                                  |
|--|-----------------------------------|----------------------------------|-----------------------------------|----------------------------------|
|  | 2019                              |                                  | 2018                              |                                  |
|  | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| <b>Impaired loans with a valuation allowance:</b>          |                                   |                                  |                                   |                                  |
| Commercial and Industrial                                  | \$ 1,310                          | \$ —                             | \$ 1,835                          | \$ —                             |
| Cash, Securities, and Other                                | 185                               | —                                | —                                 | —                                |
| Total  | <u>\$ 1,495</u>                   | <u>\$ —</u>                      | <u>\$ 1,835</u>                   | <u>\$ —</u>                      |
| <b>Impaired loans with no related valuation allowance:</b> |                                   |                                  |                                   |                                  |
| Commercial and Industrial                                  | \$ 5,463                          | \$ 326                           | \$ —                              | \$ —                             |
| Cash, Securities, and Other                                | 8,088                             | —                                | 11,388                            | —                                |
| 1-4 Family Residential                                     | 1,213                             | 77                               | —                                 | —                                |
| Total  | <u>\$ 14,764</u>                  | <u>\$ 403</u>                    | <u>\$ 11,388</u>                  | <u>\$ —</u>                      |
| <b>Total impaired loans:</b>                               |                                   |                                  |                                   |                                  |
| Commercial and Industrial                                  | \$ 6,773                          | \$ 326                           | \$ 1,835                          | \$ —                             |
| Cash, Securities, and Other                                | 8,273                             | —                                | 11,388                            | —                                |
| 1-4 Family Residential                                     | 1,213                             | 77                               | —                                 | —                                |
| Total  | <u>\$ 16,259</u>                  | <u>\$ 403</u>                    | <u>\$ 13,223</u>                  | <u>\$ —</u>                      |

#### *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,<br>Securities<br>and Other | Construction<br>and<br>Development | 1-4<br>Family<br>Residential | Non-Owner<br>Occupied<br>CRE | Owner<br>Occupied<br>CRE | Commercial<br>and<br>Industrial | Total             |
|---|----------------------------------|------------------------------------|------------------------------|------------------------------|--------------------------|---------------------------------|-------------------|
| <b>Changes in allowance for loan losses for the three months ended September 30, 2019</b>           |                                  |                                    |                              |                              |                          |                                 |                   |
| Beginning balance   | \$ 1,049                         | \$ 290                             | \$ 2,650                     | \$ 1,086                     | \$ 800                   | \$ 1,700                        | \$ 7,575          |
| Provision for (recovery of) credit losses   | 258                              | 18                                 | 27                           | (68)                         | 76                       | (211)                           | 100               |
| Charge-offs   | —                                | —                                  | —                            | —                            | —                        | —                               | —                 |
| Recoveries  | —                                | —                                  | —                            | —                            | —                        | —                               | —                 |
| Ending balance  | <u>\$ 1,307</u>                  | <u>\$ 308</u>                      | <u>\$ 2,677</u>              | <u>\$ 1,018</u>              | <u>\$ 876</u>            | <u>\$ 1,489</u>                 | <u>\$ 7,675</u>   |
| <b>Changes in allowance for loan losses for the nine months ended September 30, 2019</b>            |                                  |                                    |                              |                              |                          |                                 |                   |
| Beginning balance   | \$ 764                           | \$ 232                             | \$ 2,552                     | \$ 1,264                     | \$ 789                   | \$ 1,850                        | \$ 7,451          |
| Provision for (recovery of) credit losses   | 535                              | 76                                 | 125                          | (246)                        | 87                       | (361)                           | 216               |
| Charge-offs   | —                                | —                                  | —                            | —                            | —                        | —                               | —                 |
| Recoveries  | 8                                | —                                  | —                            | —                            | —                        | —                               | 8                 |
| Ending balance  | <u>\$ 1,307</u>                  | <u>\$ 308</u>                      | <u>\$ 2,677</u>              | <u>\$ 1,018</u>              | <u>\$ 876</u>            | <u>\$ 1,489</u>                 | <u>\$ 7,675</u>   |
| <b>Allowance for loan losses at September 30, 2019 allocated to loans evaluated for impairment:</b> |                                  |                                    |                              |                              |                          |                                 |                   |
| Individually  | \$ 247                           | \$ —                               | \$ —                         | \$ —                         | \$ —                     | \$ 693                          | \$ 940            |
| Collectively  | 1,060                            | 308                                | 2,677                        | 1,018                        | 876                      | 796                             | 6,735             |
| Ending balance  | <u>\$ 1,307</u>                  | <u>\$ 308</u>                      | <u>\$ 2,677</u>              | <u>\$ 1,018</u>              | <u>\$ 876</u>            | <u>\$ 1,489</u>                 | <u>\$ 7,675</u>   |
| <b>Loans at September 30, 2019, evaluated for impairment:</b>                                       |                                  |                                    |                              |                              |                          |                                 |                   |
| Individually  | \$ 5,264                         | \$ —                               | \$ 1,213                     | \$ —                         | \$ —                     | \$ 7,503                        | \$ 13,980         |
| Collectively  | 141,358                          | 42,059                             | 365,025                      | 138,753                      | 119,497                  | 103,684                         | 910,376           |
| Ending balance  | <u>\$ 146,622</u>                | <u>\$ 42,059</u>                   | <u>\$ 366,238</u>            | <u>\$ 138,753</u>            | <u>\$ 119,497</u>        | <u>\$ 111,187</u>               | <u>\$ 924,356</u> |

|  | Cash,<br>Securities<br>and Other | Construction<br>and<br>Development | 1-4<br>Family<br>Residential | Non-Owner<br>Occupied<br>CRE | Owner<br>Occupied<br>CRE | Commercial<br>and<br>Industrial | Total             |
|--|----------------------------------|------------------------------------|------------------------------|------------------------------|--------------------------|---------------------------------|-------------------|
| <b>Changes in allowance for loan losses for the three months ended September 30, 2018</b>          |                                  |                                    |                              |                              |                          |                                 |                   |
| Beginning balance  | \$ 934                           | \$ 227                             | \$ 1,957                     | \$ 1,199                     | \$ 626                   | \$ 2,157                        | \$ 7,100          |
| Provision for (recovery of) credit losses  | (94)                             | 12                                 | 132                          | 11                           | (22)                     | (21)                            | 18                |
| Charge-offs  | —                                | —                                  | —                            | —                            | —                        | —                               | —                 |
| Recoveries   | —                                | —                                  | —                            | —                            | —                        | —                               | —                 |
| Ending balance   | <u>\$ 840</u>                    | <u>\$ 239</u>                      | <u>\$ 2,089</u>              | <u>\$ 1,210</u>              | <u>\$ 604</u>            | <u>\$ 2,136</u>                 | <u>\$ 7,118</u>   |
| <b>Changes in allowance for loan losses for the nine months ended September 30, 2018</b>           |                                  |                                    |                              |                              |                          |                                 |                   |
| Beginning balance  | \$ 1,066                         | \$ 202                             | \$ 2,283                     | \$ 1,433                     | \$ 751                   | \$ 1,552                        | \$ 7,287          |
| Provision for (recovery of) credit losses  | (226)                            | 37                                 | (194)                        | (223)                        | (147)                    | 584                             | (169)             |
| Charge-offs  | —                                | —                                  | —                            | —                            | —                        | —                               | —                 |
| Recoveries   | —                                | —                                  | —                            | —                            | —                        | —                               | —                 |
| Ending balance   | <u>\$ 840</u>                    | <u>\$ 239</u>                      | <u>\$ 2,089</u>              | <u>\$ 1,210</u>              | <u>\$ 604</u>            | <u>\$ 2,136</u>                 | <u>\$ 7,118</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 September 30, 2019 and December 31, 2018 (in thousands):

| <b>September 30, 2019</b>    | <b>Pass</b>       | <b>Special<br/>Mention</b> | <b>Substandard</b> | <b>Total</b>      |
|------------------------------|-------------------|----------------------------|--------------------|-------------------|
| Cash, Securities and Other   | \$ 141,358        | \$ —                       | \$ 5,264           | \$ 146,622        |
| Construction and Development | 42,059            | —                          | —                  | 42,059            |
| 1-4 Family Residential       | 359,030           | —                          | 7,208              | 366,238           |
| Non-Owner Occupied CRE       | 137,582           | 1,171                      | —                  | 138,753           |
| Owner Occupied CRE           | 119,497           | —                          | —                  | 119,497           |
| Commercial and Industrial    | 95,371            | —                          | 15,816             | 111,187           |
| <b>Total</b>                 | <b>\$ 894,897</b> | <b>\$ 1,171</b>            | <b>\$ 28,288</b>   | <b>\$ 924,356</b> |

| <b>December 31, 2018</b>     | <b>Pass</b>       | <b>Special<br/>Mention</b> | <b>Substandard</b> | <b>Total</b>      |
|------------------------------|-------------------|----------------------------|--------------------|-------------------|
| 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           |
| <b>Total</b>                 | <b>\$ 859,018</b> | <b>\$ 8,117</b>            | <b>\$ 25,660</b>   | <b>\$ 892,795</b> |

The Company had no loans graded doubtful as of September 30, 2019 and December 31, 2018.

#### **NOTE 4 - GOODWILL**

Changes in the carrying amount of goodwill were as follows:

|                                   | <b>Wealth<br/>Management</b> | <b>Capital<br/>Management</b> | <b>Consolidated</b> |
|-----------------------------------|------------------------------|-------------------------------|---------------------|
| Balance at December 31, 2018      | \$ 15,994                    | \$ 8,817                      | \$ 24,811           |
| Impairment                        | -                            | (1,572)                       | (1,572)             |
| Reclass of goodwill held for sale | -                            | (3,553)                       | (3,553)             |
| Balance at September 30, 2019     | <u>\$ 15,994</u>             | <u>\$ 3,692</u>               | <u>\$ 19,686</u>    |

Goodwill is tested annually for impairment on October 31 or earlier upon the occurrence of certain events. During the second quarter of 2019, the Company received an unsolicited offer to purchase its Los Angeles-based fixed income team, a portion of the Capital Management segment. The Company determined the sale of a portion of this segment would benefit the Company by optimizing the cost structure and freeing up capital and resources to strengthen the Wealth Management and Mortgage segments. The Company determined that it was more likely than not that it would sign this agreement to dispose of a portion of this segment.

The agreement to sell a portion of the Capital Management segment represented an event affecting a specific segment. As a result, the Company proceeded to perform an interim impairment test for the Capital Management segment. As part of the qualitative assessment, it did indicate that it was more likely than not that the carrying value of the Capital Management segment exceeded its fair value. Therefore, the Company proceeded to Step 1 of the interim goodwill impairment test.

Step 1 of the goodwill impairment analysis includes the determination of the carrying value of the segment, including the existing goodwill, and estimating the fair value of the segment. If the carrying amount of a segment exceeds its fair value, we are required to perform Step 2 of the impairment test.

To estimate the fair value of our segments, an independent valuation specialist assisted us and we used an income approach, specifically a discounted cash flow methodology, and a market approach. The discounted cash flow methodology includes assumptions for forecasted revenues, growth rates, discount rates, and market multiples, which all require significant judgment and estimates by management and are inherently uncertain. The fair value did not exceed the carrying value of the Capital Management segment at the time of testing. During the first half of 2019, the growth in revenue had not been realized at previously forecasted levels for the Capital Management segment. The Company had focused on revenue growth in the more core areas in Wealth Management and Mortgage. Our outlook for the Capital

Management segment had declined driven by the lower market penetration and slower growth in assets under management which had negatively impacted our near-term earnings outlook for this segment. The sale would put the team into a group with distribution capabilities and a structure to support them. As such, this had caused a downward revision for our forecast on current and projected cash flows for the Capital Management segment which resulted in a lower fair value.

Therefore, we conducted Step 2 of the goodwill impairment test for the Capital Management segment. Step 2 requires that we allocate the fair value of segment to identifiable assets and liabilities of the segment. Any residual fair value after this allocation is compared to the goodwill balance and any excess goodwill is charged to expense. As a result of our two step evaluation, we recorded a goodwill impairment loss of \$1.6 million during the second quarter of 2019 in the Capital Management segment. As of September 30, 2019, there was \$3.7 million of goodwill remaining in the Capital Management segment.

As of September 30, 2019, there was an outstanding agreement with Lido Advisors, LCC for a portion of the Capital Management segment. As such, goodwill was allocated based on the relative fair value for the portion of the segment held for sale, in the amount of \$3.6 million, and was reclassified to assets held for sale at the end of the third quarter 2019. As of September 30, 2019, the remaining value of goodwill in the Capital Management segment was \$3.7 million. For events occurring after the period which pertain to this transaction see Note 17 – Subsequent Events.

## NOTE 5 - 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 presents the classification of the right-of-use asset and corresponding liability within the condensed consolidated balance sheet. The Company elected to not include short-term leases with initial terms of twelve months or less, on the condensed consolidated balance sheet.

|                                     |                       | September 30,<br>2019 |
|-------------------------------------|-----------------------|-----------------------|
| <b>Lease Right-of-Use Assets</b>    | <b>Classification</b> |                       |
| Operating lease right-of-use assets | Other assets          | \$ 10,959             |
| <b>Lease Liabilities</b>            | <b>Classification</b> |                       |
| Operating lease liabilities         | Other liabilities     | \$ 14,284             |

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.

|  | September 30,<br>2019 |
|--|-----------------------|
| <b>Weighted-Average Remaining Lease Term</b> |                       |
| Operating leases                             | 5.08 years            |
| <b>Weighted-Average Discount Rate</b>        |                       |
| Operating leases                             | 3.70 %                |

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.

|                         | Three Months Ended<br>September 30, 2019 | Nine Months Ended<br>September 30, 2019 |
|-------------------------|--|---|
| <b>Lease Costs</b>      |  |   |
| Operating lease cost    | \$ 810                                   | \$ 2,382                                |
| Variable lease cost     | 395                                      | 1,168                                   |
| Sublease income         | (99)                                     | (298)                                   |
| <b>Lease costs, net</b> | <b>\$ 1,106</b>                          | <b>\$ 3,252</b>                         |

The Company recognized lease costs of \$1.1 million and \$3.4 million for the three and nine months ended September 30, 2018.

The following table presents 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 September 30, 2019.

|  | <b>Operating Leases</b> |
|--|-------------------------|
| <b>Twelve Months Ended</b>                         |                         |
| September 30, 2020                                 | \$ 3,601                |
| September 30, 2021                                 | 2,941                   |
| September 30, 2022                                 | 2,683                   |
| September 30, 2023                                 | 2,462                   |
| September 30, 2024                                 | 2,241                   |
| Thereafter   | 1,768                   |
| Total future minimum lease payments                | \$ 15,696               |
| Less: Imputed interest                             | (1,412)                 |
| Present value of net future minimum lease payments | <b>\$ 14,284</b>        |

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

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

## NOTE 6 - DEPOSITS

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

|   | September 30,<br>2019 | December 31,<br>2018 |
|---|-----------------------|----------------------|
| Money market deposit accounts                   | \$ 620,434            | \$ 489,506           |
| Time deposits                                   | 170,457               | 178,743              |
| Negotiable order of withdrawal accounts         | 83,022                | 64,853               |
| Savings accounts                                | 3,456                 | 1,800                |
| Total interest bearing deposits                 | <b>\$ 877,369</b>     | <b>\$ 734,902</b>    |
| Aggregate time deposits of \$250,000 or greater | <b>\$ 68,328</b>      | <b>\$ 83,550</b>     |

Overdraft balances classified as loans totaled \$0.3 million and \$0.3 million at September 30, 2019 and December 31, 2018, respectively.

## NOTE 7 - 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 September 30, 2019 and December 31, 2018 amounted to \$536.9 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 \$366.2 million at September 30, 2019. Each advance is payable at its maturity date.

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

| <b>Maturity Date</b> | <b>Rate %</b> | <b>September 30, 2019</b> | <b>December 31, 2018</b> |
|----------------------|---------------|---------------------------|--------------------------|
| August 2, 2019       | 2.65          | \$ —                      | \$ 5,000                 |
| August 26, 2020      | 1.94          | 10,000                    | 10,000                   |
| <b>Total</b>         |               | <b>\$ 10,000</b>          | <b>\$ 15,000</b>         |

The Bank has borrowing capacity associated with three unsecured federal funds lines of credit up to \$10.0 million, \$19.0 million, and \$25.0 million. As of September 30, 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 16 – Regulatory Capital Matters). As of September 30, 2019 and December 31, 2018, the Company was in compliance with the covenant requirements.

## NOTE 8 - 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 condensed 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):

|                                   | <b>September 30, 2019</b> |                      | <b>December 31, 2018</b> |                      |
|-----------------------------------|---------------------------|----------------------|--------------------------|----------------------|
|                                   | <b>Fixed Rate</b>         | <b>Variable Rate</b> | <b>Fixed Rate</b>        | <b>Variable Rate</b> |
| Unused lines of credit            | \$ 35,724                 | \$ 245,642           | \$ 33,571                | \$ 271,580           |
| Standby letters of credit         | 65                        | 23,499               | 40                       | 23,508               |
| Commitments to make loans to sell | 81,158                    | —                    | 17,207                   | —                    |
| Commitments to make loans         | —                         | 10,000               | —                        | —                    |

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 condensed consolidated financial statements.

## **NOTE 9 - 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.

On June 14, 2019, the Company announced that its Board of Directors had authorized a share repurchase program under which the Company may repurchase up to 300,000 shares of its common stock and that the Board of Governors of the Federal Reserve System advised the Company that it had no objection to the Company's stock repurchase program. The repurchase program authorizes the Company to purchase its common stock from time to time in privately negotiated transactions, in the open market, including pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 plan promulgated by the Securities and Exchange Commissions, or otherwise in a manner that complies with applicable federal securities laws. The program will be in effect for a one-year period, with the timing of purchases and the number of shares repurchased under the program dependent upon a variety of factors including price, trading volume, corporate and regulatory requirements and market conditions. The repurchase program may be suspended or discontinued at any time without notice. During the three months ended September 30, 2019, the Company repurchased 582 shares at an average price of \$14.00 and as of September 30, 2019, 299,418 shares may yet be purchased under the program.

During the nine months ended September 30, 2019 the Company sold no shares of common stock. During the nine months ended September 30, 2018, the Company sold 67,242 shares of its common stock through a Private Placement Memorandum resulting in proceeds to the Company of \$1.9 million (net of issuance costs of \$0.1 million). During three and nine months ended September 30, 2018, the Company issued 16,969 shares of common stock upon the settlement of Time Vesting Units.

### **Restricted Stock Awards**

As of September 30, 2019, the Restricted Stock Awards have a weighted-average grant date fair value of \$28.50 per share. During the three months ended September 30, 2019 and 2018, the Company recognized stock based compensation expense of \$0.5 million and \$0.1 million, respectively, associated with Restricted Stock Awards. During the nine months ended September 30, 2019 and 2018, the Company has recognized compensation expense of \$0.7 and \$0.2 million for the Restricted Stock Awards, respectively. As of September 30, 2019, the Company has \$1.9 million of unrecognized stock-based compensation expense related to the shares issued. As of September 30, 2019, the unrecognized stock-based compensation expense is expected to be recognized over a weighted average period of 3.0 years. Restricted Stock Awards representing 33,070 shares vested during the three and nine months ended September 30, 2019.

### **Stock-Based Compensation Plans**

As of September 30, 2019, there were a total of 648,414 shares available for issuance under the First Western Financial, Inc. 2016 Omnibus Incentive Plan ("the 2016 Plan"). If the Awards outstanding under the First Western 2008



Stock Incentive Plan (“the 2008 Plan”) or the 2016 Plan are forfeited, cancelled or terminated with no consideration paid to the Company, those amounts will increase the number of shares eligible to be granted under the 2016 Plan.

### Stock Options

The Company did not grant any stock options during the nine months ended September 30, 2019 and 2018.

During the three months ended September 30, 2019 and 2018, the Company recognized stock based compensation expense of \$0.1 million and \$0.1 million, respectively, associated with stock options. During the nine months ended September 30, 2019 and 2018, the Company recognized stock based compensation expense of \$0.2 million and \$0.4 million, respectively, associated with stock options. As of September 30, 2019, the Company has \$0.3 million of unrecognized stock-based compensation expense related to stock options which are unvested. As of September 30, 2019, the unrecognized cost is expected to be recognized over a weighted-average period of approximately 0.8 of a year.

The following summarizes activity for nonqualified stock options for the nine months ended September 30, 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                                     | (42,750)          | 27.72                           |   |                           |
| Outstanding at end of period                             | 423,197           | \$ 28.95                        | 3.8   | (a)                       |
| Options fully vested / exercisable at September 30, 2019 | 380,216           | \$ 29.34                        | 3.5   | (a)                       |

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

As of September 30, 2019 and December 31, 2018, there were 380,216 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.

### Restricted Stock Units

Pursuant to the 2016 Plan, the Company can grant associates and non-associate directors long-term cash and stock-based compensation. During the nine months ended September 30, 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 nine months ended September 30, 2019:

|                                  | Time Vesting Units | Financial Performance Units | Market Performance Units |
|----------------------------------|--------------------|-----------------------------|--------------------------|
| Outstanding at beginning of year | 184,369            | 15,932                      | 17,258                   |
| Granted                          | 71,127             | 59,536                      | -                        |
| Vested                           | (23,281)           | -                           | -                        |
| Forfeited                        | (22,824)           | (6,597)                     | (1,933)                  |
| Outstanding at end of period     | 209,391            | 68,871                      | 15,325                   |

During the nine months ended September 30, 2019, the Company issued 15,446 shares of common stock upon the settlement of Time Vesting Units. The remaining 7,835 shares were surrendered with a combined market value at the dates of settlement of \$0.1 million to cover employee withholding taxes. During the nine months ended September 30, 2018, the Company issued 16,969 shares of common stock upon the settlement of Time Vesting Units. The remaining 6,313 shares were surrendered with a combined market value at the dates of settlement of \$0.2 million to cover employee withholding taxes.

## Time Vesting Units

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 during the nine months ended September 30, 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 Company granted 67,348 Time Vesting Units with a five year service period in the nine months ended September 30, 2019, that vest in equal installments of 20% on the anniversary of the grant date, assuming continuous employment through the scheduled vesting dates. Time Vesting Units granted in 2019 have a weighted-average grant-date fair value of \$13.80 per unit. During the three months ended September 30, 2019 and 2018, the Company recognized compensation expense of \$0.3 million and \$0.1 million, respectively, for Time Vesting Units. During the nine months ended September 30, 2019 and 2018, the Company recognized compensation expense of \$0.7 million and \$0.7 million, respectively, for Time Vesting Units. As of September 30, 2019, there was \$3.7 million of unrecognized compensation expense related to Time Vesting Units. As of September 30, 2019, the unrecognized stock-based compensation expense is expected to be recognized over a weighted-average period of approximately 2.1 years.

## Financial Performance Units Granted Prior to 2019

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, 2019. 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. As of September 30, 2019, the Company is accruing at the maximum threshold for 50% of the awards and at 50% for the remainder. The maximum shares that can be issued at 150% as of September 30, 2019 was approximately 20,800 shares. During the nine months ended September 30, 2019 and 2018, the Company recognized an immaterial amount of compensation expense for the Financial Performance Units. As of September 30, 2019, there was \$0.2 million of unrecognized compensation expense related to the Financial Performance Units. As of September 30, 2019, the unrecognized stock-based compensation expense is expected to be recognized over a weighted-average period of 2.3 years.

## Financial Performance Units Granted in 2019

On May 1, 2019, the Company granted an additional 59,536 Financial Performance Units to officers and other key employees. All Financial Performance Units granted on May 1, 2019, have a five-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. As of September 30, 2019, the Company is accruing at the maximum threshold for the awards. The maximum shares that can be issued at 150% as of September 30, 2019 was approximately 82,500 shares. During the three months ended September 30, 2019, the Company recognized compensation expense of \$0.1 million for the Financial Performance Units. As of September 30, 2019, there was \$0.7 million of unrecognized compensation expense related to the Financial Performance Units. As of September 30, 2019, the unrecognized stock-based compensation expense is expected to be recognized over a weighted-average period of 4.3 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 and nine months ended September 30, 2019 and 2018 the Company recognized an immaterial amount of compensation expense for the Market Performance Units. As of September 30, 2019, there was \$0.4 million of unrecognized compensation expense related to the Market Performance Units which is expected to be recognized over a weighted-average period of 2.75 years.

## NOTE 10 - 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 September 30, |                 | Nine Months Ended September 30, |                 |
|--|----------------------------------|-----------------|---------------------------------|-----------------|
|  | 2019                             | 2018            | 2019                            | 2018            |
| <b>Earnings per common share - Basic</b>         |                                  |                 |                                 |                 |
| Numerator:                                       |                                  |                 |                                 |                 |
| Net income                                       | \$ 2,406                         | \$ 1,689        | \$ 5,437                        | \$ 3,923        |
| Dividends on preferred stock                     | —                                | (255)           | —                               | (1,378)         |
| Net income available for common shareholders     | <u>\$ 2,406</u>                  | <u>\$ 1,434</u> | <u>\$ 5,437</u>                 | <u>\$ 2,545</u> |
| Denominator:                                     |                                  |                 |                                 |                 |
| Basic weighted average shares                    | 7,890,794                        | 7,373,770       | 7,882,221                       | 6,321,511       |
| Earnings per common share - basic                | <u>\$ 0.30</u>                   | <u>\$ 0.19</u>  | <u>\$ 0.69</u>                  | <u>\$ 0.40</u>  |
| <b>Earnings per common share - Diluted</b>       |                                  |                 |                                 |                 |
| Numerator:                                       |                                  |                 |                                 |                 |
| Net income                                       | \$ 2,406                         | \$ 1,689        | \$ 5,437                        | \$ 3,923        |
| Dividends on preferred stock                     | —                                | (255)           | —                               | (1,378)         |
| Net income available for common shareholders     | <u>\$ 2,406</u>                  | <u>\$ 1,434</u> | <u>\$ 5,437</u>                 | <u>\$ 2,545</u> |
| Denominator:                                     |                                  |                 |                                 |                 |
| Basic weighted average shares                    | 7,890,794                        | 7,373,770       | 7,882,221                       | 6,321,511       |
| Diluted effect of common stock equivalents:      |                                  |                 |                                 |                 |
| Stock options                                    | —                                | —               | —                               | 20,860          |
| Time Vesting Units                               | 10,702                           | —               | 4,942                           | 14,841          |
| Financial Performance Units                      | 123                              | —               | 41                              | 6,505           |
| Market Performance Units                         | 13,175                           | 15,075          | 13,357                          | 5,025           |
| Restricted Stock Awards                          | —                                | —               | —                               | 3,509           |
| Total diluted effect of common stock equivalents | <u>24,000</u>                    | <u>15,075</u>   | <u>18,340</u>                   | <u>50,740</u>   |
| Diluted weighted average shares                  | 7,914,794                        | 7,388,845       | 7,900,561                       | 6,372,251       |
| Earnings per common share - diluted              | <u>\$ 0.30</u>                   | <u>\$ 0.19</u>  | <u>\$ 0.69</u>                  | <u>\$ 0.40</u>  |

Diluted earnings per share was computed without consideration to potentially dilutive instruments as their inclusion would have been anti-dilutive. As of September 30, 2019 and 2018, potentially dilutive securities excluded from the diluted earnings per share calculation are as follows:

|                                       | Three Months Ended September 30, |                | Nine Months Ended September 30, |                |
|---------------------------------------|----------------------------------|----------------|---------------------------------|----------------|
|                                       | 2019                             | 2018           | 2019                            | 2018           |
| Stock options                         | 423,197                          | 467,947        | 438,364                         | 296,949        |
| Convertible Preferred D shares        | —                                | —              | —                               | —              |
| Time Vesting Units                    | 130,821                          | 168,962        | 163,141                         | 157,454        |
| Financial Performance Units           | 55,028                           | 16,345         | 47,008                          | 5,448          |
| Market Performance Units              | —                                | —              | —                               | —              |
| Restricted Stock Awards               | 61,668                           | 43,830         | 83,713                          | 14,610         |
| Total potentially dilutive securities | <u>670,714</u>                   | <u>697,084</u> | <u>732,226</u>                  | <u>474,461</u> |

## NOTE 11 - INCOME TAXES

During the three and nine months ended September 30, 2019, the Company recorded an income tax provision of \$0.8 million and \$1.9 million, respectively, reflecting an effective tax rate of 24.5% and 25.5%, respectively. During the

three and nine months ended September 30, 2018, the Company recorded an income tax provision of \$0.5 million and \$1.2 million, respectively, reflecting an effective tax rate of 24.3% and 24.1%, respectively.

## NOTE 12 - RELATED-PARTY TRANSACTIONS

The Bank granted loans to principal officers and directors and their affiliates, all of whom are deemed related parties. At September 30, 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):

|                              | September 30, 2019 | December 31, 2018 |
|------------------------------|--------------------|-------------------|
| Balance, beginning of period | \$ 2,659           | \$ 14,077         |
| Funded loans                 | 8,295              | 1,466             |
| Payments collected           | (6,146)            | (9,386)           |
| Changes in related parties   | —                  | (3,498)           |
| Balance, end of period       | \$ 4,808           | \$ 2,659          |

Deposits from related parties held by the Bank at September 30, 2019 and December 31, 2018 totaled \$27.6 million and \$36.7 million, respectively.

The Company leases office space from an entity controlled by one of the Company's board members. During the nine months ended September 30, 2019 and 2018, the Company incurred \$0.1 million and an immaterial amount of expense related to this lease.

## NOTE 13 - 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 2019 and 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 condensed consolidated statements of income.

The following presents assets measured on a recurring basis at September 30, 2019 and December 31, 2018 (in thousands):

| September 30, 2019   | Quoted<br>Prices in<br>Active Markets<br>for Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Reported<br>Balance |
|--|---|---|--|---------------------|
| Investment securities available-for-sale:                              |   |   |  |                     |
| U.S. Treasury debt   | \$ 255  | \$ —  | \$ —   | \$ 255              |
| GNMA   | —   | 45,735  | —  | 45,735              |
| FNMA   | —   | 3,309   | —  | 3,309               |
| Securities issued by US. Government sponsored entities<br>and agencies | —   | —   | —  | —                   |
| Corporate CMO and MBS  | —   | 12,192  | —  | 12,192              |
| Total securities available-for-sale                                    | \$ 255  | \$ 61,236   | \$ —   | \$ 61,491           |
| Equity securities  | \$ 718  | \$ —  | \$ —   | \$ 718              |
| Interest rate lock and forward delivery commitments                    | \$ —  | \$ 2,148  | \$ —   | \$ 2,148            |

  

| December 31, 2018  | Quoted<br>Prices in<br>Active Markets<br>for Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Reported<br>Balance |
|--|---|---|--|---------------------|
| 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<br>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 September 30, 2019 and December 31, 2018, the majority of the securities have credit support provided by the Federal Home Loan Mortgage Corporation, GNMA, and FNMA. 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 September 30, 2019, equity securities have been recorded at fair value within the other assets line item in the condensed consolidated balance sheet with changes recorded in the other line item in the condensed consolidated statement of income.

**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 September 30, 2019 and December 31, 2018 (in thousands):

|                           | Quoted<br>Prices in<br>Active Markets<br>for Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Reported<br>Balance |
|---------------------------|---|---|--|---------------------|
| <b>September 30, 2019</b> |   |   |  |                     |
| Other real estate owned:  |   |   |  |                     |
| Commercial properties     | \$ —  | \$ —  | \$ 658   | \$ 658              |
| Total impaired loans:     |   |   |  |                     |
| Commercial and industrial | \$ —  | \$ —  | \$ 342   | \$ 342              |
| <b>December 31, 2018</b>  |   |   |  |                     |
| Other real estate owned:  |   |   |  |                     |
| Commercial properties     | \$ —  | \$ —  | \$ 658   | \$ 658              |
| Total impaired loans:     |   |   |  |                     |
| Commercial and industrial | \$ —  | \$ —  | \$ 795   | \$ 795              |

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

At September 30, 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 September 30, 2019, total impaired loans measured for impairment using the fair value of the collateral for collateral dependent loans had carrying values of \$1.3 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 September 30, 2019 and December 31, 2018.

Impaired loans accounted for no provisions for loan losses for the three and nine months ended September 30, 2019.

The following presents carrying amounts and estimated fair values for financial instruments as of September 30, 2019 and December 31, 2018 (in thousands):

| September 30, 2019                               | Carrying Amount | Fair Value Measurements Using: |           |         |  |
|--|-----------------|--------------------------------|-----------|---------|--|
|  |                 | Level 1                        | Level 2   | Level 3 |  |
| Assets:  |                 |                                |           |         |  |
| Cash and cash equivalents                        | \$ 146,176      | \$ 146,176                     | \$ —      | \$ —    |  |
| Securities available-for-sale                    | 61,491          | 255                            | 61,236    | —       |  |
| Loans, net                                       | 918,911         | —                              | —         | 899,750 |  |
| Mortgage loans held for sale                     | 69,231          | —                              | 69,231    | —       |  |
| Accrued interest receivable                      | 2,968           | —                              | 2,968     | —       |  |
| Other assets                                     | 718             | 718                            | —         | —       |  |
| Liabilities:                                     |                 |                                |           |         |  |
| Deposits   | 1,108,904       | —                              | 1,111,853 | —       |  |
| Borrowings:                                      |                 |                                |           |         |  |
| FHLB Topeka Borrowings – fixed rate              | 10,000          | —                              | 9,983     | —       |  |
| 2016 Subordinated notes – fixed-to-floating rate | 6,560           | —                              | —         | 6,110   |  |
| Accrued interest payable                         | 356             | —                              | 356       | —       |  |
|  |                 |                                |           |         |  |
| 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 14 – ASSETS AND LIABILITIES CLASSIFIED AS HELD FOR SALE

At June 30, 2019, the Company determined that it was more likely than not that it would sign an agreement to dispose of a portion of the Capital Management segment. See note 15 – Segment Reporting for further information. The Company proceeded to perform an interim impairment test for the Capital Management segment, as a result of this evaluation, an impairment loss of \$1.6 million was recorded during the nine months ended September 30, 2019, no impairment loss was recorded during the three months ended September 30, 2019. See note 4 – Goodwill for further information.

On July 19, 2019, the Company entered into an agreement to sell the Company's Los Angeles-based fixed income portfolio management team to Lido Advisors, LLC and Oakhurst Advisors, LLC. As of September 30, 2019, the sale was not yet completed and the assets and related liabilities attributable to the sale, which were expected to be sold within twelve months, were classified as a disposal group held for sale and are presented separately in the consolidated balance sheet.

On November 1, 2019, the Company announced the proposed sale of the Los Angeles-based fixed income portfolio management team and certain advisory and sub-advisory arrangements to Lido Advisors, LLC and Oakhurst Advisors, LLC was cancelled. Management will continue to evaluate other opportunities to divest the Los Angeles-based fixed income portfolio management team. As a result, the disposal group held for sale classification remains appropriate.

Assets and liabilities in disposal groups held for sale are as follows at the dates noted (in thousands):

|  | September 30,<br>2019 | December 31,<br>2018 |
|--|-----------------------|----------------------|
| <b>ASSETS</b>                                |                       |                      |
| Goodwill                                     | \$ 3,553              | \$ —                 |
| Assets in disposal groups held for sale      | \$ 3,553              | \$ —                 |
| <b>LIABILITIES</b>                           |                       |                      |
| Other liabilities                            | \$ 111                | \$ —                 |
| Liabilities in disposal groups held for sale | \$ 111                | \$ —                 |

## NOTE 15 - 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 and nine months ended September 30, 2019 and 2018 (in thousands):

| Three Months Ended September 30, 2019 | Wealth<br>Management | Capital<br>Management | Mortgage  | Consolidated |
|---------------------------------------|----------------------|-----------------------|-----------|--------------|
| <b>Income Statement</b>               |                      |                       |           |              |
| Total interest income                 | \$ 11,473            | \$ —                  | \$ —      | \$ 11,473    |
| Total interest expense                | 3,533                | —                     | —         | 3,533        |
| Provision for loan losses             | 100                  | —                     | —         | 100          |
| Net interest income                   | 7,840                | —                     | —         | 7,840        |
| Non-interest income                   | 4,714                | 776                   | 3,298     | 8,788        |
| Total income                          | 12,554               | 776                   | 3,298     | 16,628       |
| Depreciation and amortization expense | 274                  | 22                    | 55        | 351          |
| All other non-interest expense        | 10,434               | 701                   | 1,956     | 13,091       |
| Income before income tax              | \$ 1,846             | \$ 53                 | \$ 1,287  | \$ 3,186     |
| Goodwill                              | \$ 15,994            | \$ 3,692              | \$ —      | \$ 19,686    |
| Assets held for sale                  | —                    | 3,553                 | —         | 3,553        |
| <b>Total assets</b>                   | \$ 1,195,340         | \$ 8,528              | \$ 68,057 | \$ 1,271,925 |



| Three Months Ended September 30, 2018       | Wealth<br>Management | Capital<br>Management | Mortgage         | Consolidated        |
|---|----------------------|-----------------------|------------------|---------------------|
| <b>Income Statement</b>                     |                      |                       |                  |                     |
| Total interest income                       | \$ 9,940             | \$ —                  | \$ —             | \$ 9,940            |
| Total interest expense                      | 2,152                | —                     | —                | 2,152               |
| Provision for loan losses                   | 18                   | —                     | —                | 18                  |
| Net interest income                         | 7,770                | —                     | —                | 7,770               |
| Non-interest income                         | 4,613                | 850                   | 1,175            | 6,638               |
| Total income                                | 12,383               | 850                   | 1,175            | 14,408              |
| Depreciation and amortization expense       | 323                  | 130                   | 104              | 557                 |
| All other non-interest expense              | 9,675                | 606                   | 1,338            | 11,619              |
| Income (loss) before income tax             | \$ 2,385             | \$ 114                | \$ (267)         | \$ 2,232            |
| Goodwill                                    | \$ 15,994            | \$ 8,817              | \$ —             | \$ 24,811           |
| <b>Total assets</b>                         | <b>\$ 1,022,436</b>  | <b>\$ 9,853</b>       | <b>\$ 19,238</b> | <b>\$ 1,051,527</b> |
| <b>Nine Months Ended September 30, 2019</b> |                      |                       |                  |                     |
| <b>Income Statement</b>                     |                      |                       |                  |                     |
| Total interest income                       | \$ 33,698            | \$ -                  | \$ -             | \$ 33,698           |
| Total interest expense                      | 9,827                | -                     | -                | 9,827               |
| Provision for loan losses                   | 216                  | -                     | -                | 216                 |
| Net-interest income                         | 23,655               | -                     | -                | 23,655              |
| Non-interest income                         | 13,956               | 2,339                 | 8,053            | 24,348              |
| Total income                                | 37,611               | 2,339                 | 8,053            | 48,003              |
| Depreciation and amortization expense       | 902                  | 248                   | 197              | 1,347               |
| All other non-interest expense              | 30,935               | 3,709 <sup>(1)</sup>  | 4,710            | 39,354              |
| Income (loss) before income tax             | \$ 5,774             | \$ (1,618)            | \$ 3,146         | \$ 7,302            |
| Goodwill                                    | \$ 15,994            | \$ 3,692              | \$ —             | \$ 19,686           |
| Assets held for sale                        | —                    | 3,553                 | —                | 3,553               |
| <b>Total assets</b>                         | <b>\$ 1,195,340</b>  | <b>\$ 8,528</b>       | <b>\$ 68,057</b> | <b>\$ 1,271,925</b> |

(1) Includes goodwill impairment charge of \$1.6 million.

| Nine Months Ended September 30, 2018  | Wealth<br>Management | Capital<br>Management | Mortgage         | Consolidated        |
|---------------------------------------|----------------------|-----------------------|------------------|---------------------|
| <b>Income Statement</b>               |                      |                       |                  |                     |
| Total interest income                 | \$ 28,451            | \$ —                  | \$ —             | \$ 28,451           |
| Total interest expense                | 5,726                | —                     | —                | 5,726               |
| Recovery of loan losses               | (169)                | —                     | —                | (169)               |
| Net-interest income                   | 22,894               | —                     | —                | 22,894              |
| Non-interest income                   | 14,457               | 2,556                 | 3,809            | 20,822              |
| Total income                          | 37,351               | 2,556                 | 3,809            | 43,716              |
| Depreciation and amortization expense | 963                  | 393                   | 351              | 1,707               |
| All other non-interest expense        | 29,839               | 2,882                 | 4,118            | 36,839              |
| Income (loss) before income tax       | \$ 6,549             | \$ (719)              | \$ (660)         | \$ 5,170            |
| Goodwill                              | \$ 15,994            | \$ 8,817              | \$ —             | \$ 24,811           |
| <b>Total assets</b>                   | <b>\$ 1,022,436</b>  | <b>\$ 9,853</b>       | <b>\$ 19,238</b> | <b>\$ 1,051,527</b> |

## NOTE 16 - 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 September 30, 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. 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 September 30, 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 September 30, 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 September 30, 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 September 30, 2019, that 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 September 30, 2019 and December 31, 2018.

The following presents the actual and required capital amounts and ratios as of September 30, 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>September 30, 2019</b>                          |           |         |  |       |   |       |
| Common Equity Tier 1(CET1) to risk-weighted assets |           |         |  |       |   |       |
| Bank   | \$ 96,495 | 10.98 % | \$ 39,547                              | 4.5 % | \$ 57,123   | 6.5 % |
| Consolidated                                       | 103,458   | 11.73   | N/A                                    | N/A   | N/A   | N/A   |
| Tier 1 capital to risk-weighted assets             |           |         |  |       |   |       |
| Bank   | 96,495    | 10.98   | 52,729                                 | 6.0   | 70,305  | 8.0   |
| Consolidated                                       | 103,458   | 11.73   | N/A                                    | N/A   | N/A   | N/A   |
| Total capital to risk-weighted assets              |           |         |  |       |   |       |
| Bank   | 104,323   | 11.87   | 70,305                                 | 8.0   | 87,882  | 10.0  |
| Consolidated                                       | 117,846   | 13.36   | N/A                                    | N/A   | N/A   | N/A   |
| Tier 1 capital to average assets                   |           |         |  |       |   |       |
| Bank   | 96,495    | 8.19    | 47,101                                 | 4.0   | 58,876  | 5.0   |
| Consolidated                                       | 103,458   | 8.76    | N/A                                    | N/A   | N/A   | N/A   |

| December 31, 2018                                  | Actual    |         | Required for Capital Adequacy Purposes |       | To be Well Capitalized Under Prompt Corrective Action Regulations |       |
|--|-----------|---------|--|-------|---|-------|
|  | Amount    | Ratio   | Amount                                 | Ratio | Amount  | Ratio |
| 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 17 - SUBSEQUENT EVENTS

On November 1, 2019, the Company cancelled the agreement to sell the Company's Los Angeles-based fixed income portfolio management team, a portion of the Capital Management segment, to Lido Advisors, LLC and Oakhurst Advisors, LLC.

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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 and nine months ended September 30, 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 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 September 30, 2019, we have expanded our footprint into nine full service profit centers, three loan production offices, two trust offices, and one registered investment advisor located across four states. As of and for the nine months ended September 30, 2019, we had \$1.3 billion in total assets, \$48.0 million in total income before non-interest expense and provided fiduciary and advisory services on \$6.1 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 is comprised primarily 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 gain on mortgage loans sold*—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 gain on mortgage loans sold are primarily impacted by the amount of loans sold, the type of loans sold and market conditions.
- *Bank fees*—income generated through bank-related service charges such as: electronic transfer fees, treasury management fees, bill pay fees, and other banking fees. Bank fees are primarily impacted by the level of business activities and cash movement activities of our clients.
- *Net gain on sale of securities*—proceeds from the sale of securities that exceed the Companies carrying value. Net gain on sale of securities are primarily impacted by the amount of securities sold and market conditions.
- *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. Federal Deposit Insurance Corporation (“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 of other intangible assets*—represents the amortization of intangible assets including client lists and other similar items recognized in connection with acquisitions.
- *Goodwill impairment*—represents the result of goodwill impairment testing. Testing for impairment occurs annually or following a triggering event. Triggering events can include adverse changes in the general condition of the economy, increased competitive environment, more-likely-than-not expectation of selling or disposing a segment, legal implications, and changes in key personnel.
- *Other*—includes costs related to expenses associated with office supplies, postage, travel expenses, meals and entertainment, dues and memberships, costs to maintain or prepare other real estate owned (“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 15 - Segment Reporting of the accompanying Notes to the Condensed 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 problems; 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 September 30, 2019, our Bank capital ratios exceeded the current well capitalized regulatory requirements established under Basel III.

### **Recent Events**

On November 1, 2019, the Company cancelled the agreement to sell the Company's Los Angeles-based fixed income portfolio management team, a portion of the Capital Management segment, to Lido Advisors, LLC and Oakhurst Advisors, LLC.

### **Results of Operations**

#### *Overview*

*The three months ended September 30, 2019 compared with the three months ended September 30, 2018.* We reported net income available to common shareholders of \$2.4 million for the three months ended September 30, 2019, compared to \$1.4 million of net income available to common shareholders, after paying dividends to preferred shareholders for the three months ended September 30, 2018, a \$1.0 million, or 67.8%, increase. For the three months ended September 30, 2019, our income before income tax was \$3.2 million, a \$1.0 million, or 42.7%, increase from the three months ended September 30, 2018. For the three months ended September 30, 2019, income before income tax increased primarily as a result of a \$2.1 million, or 184.0%, increase in gains on mortgage loans sold which was partially offset by an increase of \$1.3 million, or 17.8%, in salaries and employee benefits expense compared to the three months ended September 30, 2018. For the three months ended September 30, 2019, net income was \$2.4 million, a \$0.7 million, or 42.5%, increase compared to the three months ended September 30, 2018.

*The nine months ended September 30, 2019 compared with the nine months ended September 30, 2018.* We reported net income available to common shareholders of \$5.4 million for the nine months ended September 30, 2019, compared to \$2.5 million of net income available to common shareholders, after paying dividends to preferred shareholders for the nine months ended September 30, 2018, a \$2.9 million, or 113.6%, increase. For the nine months ended September 30, 2019, our income before income tax was \$7.3 million, a \$2.1 million, or 41.2%, increase from the nine months ended September 30, 2018. For the nine months ended September 30, 2019, income before income tax increased primarily as a result of a \$4.2 million, or 112.5%, increase in gains on mortgage loans sold partially offset by goodwill impairment of \$1.6 million compared to the nine months ended September 30, 2018. For the nine months ended September 30, 2019, net income was \$5.4 million, a \$1.5 million, or 38.6%, increase compared to the nine months ended September 30, 2018.

Financial results for the nine months ended September 30, 2019 include a \$1.6 million goodwill impairment charge related to the announced sale of the Company's Los Angeles-based fixed income team (a component of the Company's Capital Management segment), which negatively impacted earnings per diluted share by 15 cents.

#### *Net Interest Income*

*The three months ended September 30, 2019 compared with the three months ended September 30, 2018.* For the three months ended September 30, 2019, net interest income, before the provision for loan losses was \$7.9 million, an increase of \$0.2 million, or 2.0%, compared to the three months ended September 30, 2018. This increase was partially attributable to a \$79.6 million increase in average outstanding loan balances compared to September 30, 2018, along with an increase in our average yield on loans to 4.55% from 4.42% for the three months ended September 30, 2019 and 2018, respectively. The increase in interest income was mostly offset by an increase in interest expense. This was attributable to a \$144.1 million increase in average funding balances compared to the three months ended September 30, 2018, along with an increase in our average cost of funds to 1.33% from 0.93% for the three months ended September 30, 2019 and 2018, respectively. For the three months ended September 30, 2019, our net interest margin was 2.95% and our net interest spread was 2.58%. For the three months ended September 30, 2018, our net interest margin was 3.29% and our net interest spread was 2.96%.

*The nine months ended September 30, 2019 compared with the nine months ended September 30, 2018.* For the nine months ended September 30, 2019, net interest income, before the provision for loan losses was \$23.9 million, an increase of \$1.1 million, or 5.0%, compared to the nine months ended September 30, 2018. This increase was partially attributable to an \$89.6 million increase in average outstanding loan balances compared to September 30, 2018, along with an increase in our average yield on loans to 4.52% from 4.32% for the nine months ended September 30, 2019 and 2018, respectively. The increase in interest income was mostly offset by an increase in interest expense. This was attributable to a \$121.5 million increase in average funding balances compared to the nine months ended September 30, 2018, along with an increase in our average cost of funds to 1.28% from 0.85% for the nine months ended September 30, 2019 and 2018, respectively. For the nine months ended September 30, 2019, our net interest margin was 3.03% and our net interest spread was 2.63%. For the nine months ended September 30, 2018, our net interest margin was 3.27% and our net interest spread was 2.98%.

The increase in average loans outstanding for the three and nine months ended September 30, 2019 compared to the same periods in 2018 was primarily due to growth in all of our major loan categories except for Non-Owner Occupied Commercial Real Estate ("CRE") and Commercial and Industrial. 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 and nine months ended September 30, 2019 compared to the same periods in 2018. Our average yields on available-for-sale securities during the three and nine months ended September 30, 2019 were 2.43% and 2.47%, a 23 and 27 basis point increase, respectively, compared to the same periods in 2018. Our average available-for-sale securities balance during the three and nine months ended September 30, 2019 were \$51.4 million and \$51.6 million, an increase of \$2.9 million and \$1.6 million, respectively, compared to the same periods in 2018.

Interest expense on deposits increased during the three and nine months ended September 30, 2019 compared to the same period in 2018. The increase was driven primarily by a rising rate environment and mix of deposit types, which resulted in increases in rates on depository accounts as cost of funds increased to 1.33% from 0.93% and to 1.28% from 0.85% during the three and nine months ended September 30, 2019 compared to the same period in 2018. In addition, average interest-bearing deposit accounts increased \$186.0 million and \$156.5 million, for the three and nine months ended September 30, 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 September 30,        |                                |                        |                      |                                |                        |                      |
|---|--------------------------------|------------------------|----------------------|--------------------------------|------------------------|----------------------|
| (Dollars in thousands)                                    | 2019                           |                        |                      | 2018                           |                        |                      |
|   | 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 | \$ 88,782                      | \$ 489                 | 2.20 %               | \$ 41,538                      | \$ 206                 | 1.98 %               |
| Available-for-sale securities <sup>(2)</sup>              | 51,368                         | 312                    | 2.43                 | 48,438                         | 266                    | 2.20                 |
| Loans <sup>(3)</sup>                                      | 937,260                        | 10,672                 | 4.55                 | 857,676                        | 9,468                  | 4.42                 |
| Interest-earning assets <sup>(4)</sup>                    | 1,077,410                      | 11,473                 | 4.26                 | 947,652                        | 9,940                  | 4.20                 |
| Mortgage loans held-for-sale <sup>(5)</sup>               | 52,546                         | 454                    | 3.46                 | 22,294                         | 243                    | 4.36                 |
| Total interest-earning assets, plus loans held-for-sale   | 1,129,956                      | 11,927                 | 4.22                 | 969,946                        | 10,183                 | 4.20                 |
| Allowance for loan losses                                 | (7,584)                        |                        |                      | (7,141)                        |                        |                      |
| Noninterest-earning assets                                | 81,171                         |                        |                      | 72,922                         |                        |                      |
| Total assets  | \$ 1,203,543                   |                        |                      | \$ 1,035,727                   |                        |                      |
| <b>Liabilities and Shareholders' Equity</b>               |                                |                        |                      |                                |                        |                      |
| Interest-bearing liabilities:                             |                                |                        |                      |                                |                        |                      |
| Interest-bearing deposits                                 | \$ 826,490                     | \$ 3,363               | 1.63 %               | \$ 640,507                     | \$ 1,761               | 1.10 %               |
| Federal Home Loan Bank Topeka borrowings                  | 10,367                         | 51                     | 1.93                 | 44,804                         | 230                    | 2.05                 |
| Subordinated notes  | 6,560                          | 119                    | 7.26                 | 8,489                          | 161                    | 7.59                 |
| Total interest-bearing liabilities                        | 843,617                        | 3,533                  | 1.68                 | 693,800                        | 2,152                  | 1.24                 |
| Noninterest-bearing liabilities:                          |                                |                        |                      |                                |                        |                      |
| Noninterest-bearing deposits                              | 215,721                        |                        |                      | 221,411                        |                        |                      |
| Other liabilities   | 19,881                         |                        |                      | 8,132                          |                        |                      |
| Total noninterest-bearing liabilities                     | 235,602                        |                        |                      | 229,543                        |                        |                      |
| Shareholders' equity                                      | 124,324                        |                        |                      | 112,384                        |                        |                      |
| Total liabilities and shareholders' equity                | \$ 1,203,543                   |                        |                      | \$ 1,035,727                   |                        |                      |
| Net interest rate spread <sup>(6)</sup>                   |                                |                        | 2.58 %               |                                |                        | 2.96 %               |
| Net interest income <sup>(7)</sup>                        |                                | \$ 7,940               |                      |                                | \$ 7,788               |                      |
| Net interest margin <sup>(8)</sup>                        |                                |                        | 2.95 %               |                                |                        | 3.29 %               |

  

| As of and For the Nine Months Ended September 30,         |                                |                        |                      |                                |                        |                      |
|---|--------------------------------|------------------------|----------------------|--------------------------------|------------------------|----------------------|
| (Dollars in thousands)                                    | 2019                           |                        |                      | 2018                           |                        |                      |
|   | 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 | \$ 71,799                      | \$ 1,254               | 2.33 %               | \$ 37,840                      | \$ 483                 | 1.70 %               |
| Available-for-sale securities <sup>(2)</sup>              | 51,565                         | 954                    | 2.47                 | 49,997                         | 824                    | 2.20                 |
| Loans <sup>(3)</sup>                                      | 928,112                        | 31,490                 | 4.52                 | 838,525                        | 27,144                 | 4.32                 |
| Interest-earning assets <sup>(4)</sup>                    | 1,051,476                      | 33,698                 | 4.27                 | 926,362                        | 28,451                 | 4.10                 |
| Mortgage loans held-for-sale <sup>(5)</sup>               | 32,569                         | 872                    | 3.57                 | 24,107                         | 745                    | 4.12                 |
| Total interest-earning assets, plus loans held-for-sale   | 1,084,045                      | 34,570                 | 4.25                 | 950,469                        | 29,196                 | 4.10                 |
| Allowance for loan losses                                 | (7,599)                        |                        |                      | (7,137)                        |                        |                      |
| Noninterest-earning assets                                | 86,047                         |                        |                      | 71,365                         |                        |                      |
| Total assets  | \$ 1,162,493                   |                        |                      | \$ 1,014,697                   |                        |                      |
| <b>Liabilities and Shareholders' Equity</b>               |                                |                        |                      |                                |                        |                      |
| Interest-bearing liabilities:                             |                                |                        |                      |                                |                        |                      |
| Interest-bearing deposits                                 | \$ 776,575                     | \$ 9,268               | 1.59 %               | \$ 620,037                     | \$ 4,332               | 0.93 %               |
| Federal Home Loan Bank Topeka borrowings                  | 12,964                         | 202                    | 2.08                 | 51,463                         | 720                    | 1.87                 |
| Subordinated notes  | 6,560                          | 357                    | 7.26                 | 11,768                         | 674                    | 7.64                 |
| Total interest-bearing liabilities                        | 796,099                        | 9,827                  | 1.65                 | 683,268                        | 5,726                  | 1.12                 |
| Noninterest-bearing liabilities:                          |                                |                        |                      |                                |                        |                      |
| Noninterest-bearing deposits                              | 225,512                        |                        |                      | 216,836                        |                        |                      |
| Other liabilities   | 19,376                         |                        |                      | 7,699                          |                        |                      |
| Total noninterest-bearing liabilities                     | 244,888                        |                        |                      | 224,535                        |                        |                      |
| Shareholders' equity                                      | 121,506                        |                        |                      | 106,894                        |                        |                      |
| Total liabilities and shareholders' equity                | \$ 1,162,493                   |                        |                      | \$ 1,014,697                   |                        |                      |
| Net interest rate spread <sup>(6)</sup>                   |                                |                        | 2.63 %               |                                |                        | 2.98 %               |
| Net interest income <sup>(7)</sup>                        |                                | \$ 23,871              |                      |                                | \$ 22,725              |                      |
| Net interest margin <sup>(8)</sup>                        |                                |                        | 3.03 %               |                                |                        | 3.27 %               |

(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) Tax-equivalent yield adjustments are immaterial.
- (5) 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 gain on mortgage loans sold line in the condensed consolidated income statement. These balances are excluded from the margin calculations in these tables.
- (6) 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.
- (7) Net interest income is income earned on interest-earning assets, which does not include interest earned on mortgage loans held-for-sale.
- (8) 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<br>September 30, 2019<br>Compared to 2018 |          |                                 | Nine Months Ended September 30, 2019<br>Compared to 2018 |            |                                 |
|---|--|----------|---------------------------------|--|------------|---------------------------------|
|   | Increase<br>(Decrease) Due<br>to Change in:                  |          | Total<br>Increase<br>(Decrease) | Increase<br>(Decrease) Due<br>to Change in:              |            | Total<br>Increase<br>(Decrease) |
|   | Volume   | Rate     |                                 | Volume   | Rate       |                                 |
| Interest-earning assets:                                  |  |          |                                 |  |            |                                 |
| Interest-bearing deposits in other financial institutions | \$ 260   | \$ 23    | \$ 283                          | \$ 593   | \$ 178     | \$ 771                          |
| Available-for-sale securities                             | 18   | 28       | 46                              | 29   | 101        | 130                             |
| Loans   | 906  | 298      | 1,204                           | 3,040  | 1,306      | 4,346                           |
| Total increase in interest income                         | \$ 1,184   | \$ 349   | \$ 1,533                        | \$ 3,662   | \$ 1,585   | \$ 5,247                        |
| Interest-bearing liabilities:                             |  |          |                                 |  |            |                                 |
| Interest-bearing deposits                                 | \$ 757   | \$ 845   | \$ 1,602                        | \$ 1,868   | \$ 3,068   | \$ 4,936                        |
| Federal Home Loan Bank Topeka borrowings                  | (165)  | (14)     | (179)                           | (598)  | 80         | (518)                           |
| Subordinated notes  | (35)   | (7)      | (42)                            | (283)  | (33)       | (316)                           |
| Total increase in interest expense                        | \$ 557   | \$ 824   | \$ 1,381                        | \$ 987   | \$ 3,115   | \$ 4,102                        |
| Increase (decrease) in net interest income                | \$ 627   | \$ (475) | \$ 152                          | \$ 2,675   | \$ (1,530) | \$ 1,145                        |

#### Non-Interest Income

The three months ended September 30, 2019 compared with the three months ended September 30, 2018. For the three months ended September 30, 2019 compared to the three months ended September 30, 2018, non-interest income increased \$2.2 million, or 32.4%, to \$8.8 million. The increase in non-interest income during the three months ended September 30, 2019 was primarily a result of a \$2.1 million increase in net gain on mortgage loans sold.

The nine months ended September 30, 2019 compared with the nine months ended September 30, 2018. For the nine months ended September 30, 2019 compared to the nine months ended September 30, 2018, non-interest income increased \$3.5 million, or 16.9%, to \$24.3 million. The increase in non-interest income during the nine months ended September 30, 2019 was primarily a result of an increase in net gain on mortgage loans sold of \$4.2 million, partially offset by a decrease in bank fees of \$0.5 million and a \$0.2 million decrease in trust and investment management fees, compared to the same period in 2018.

The table below presents the significant categories of our non-interest income for the three and nine months ended September 30, 2019 and 2018:

| (Dollars in thousands)                 | Three Months Ended<br>September 30, |          | Change   |        |
|--|-------------------------------------|----------|----------|--------|
|  | 2019                                | 2018     | \$       | %      |
| <b>Non-interest income:</b>            |                                     |          |          |        |
| Trust and investment management fees   | \$ 4,824                            | \$ 4,770 | \$ 54    | 1.1 %  |
| Net gain on mortgage loans sold        | 3,291                               | 1,159    | 2,132    | 184.0  |
| Banking fees                           | 283                                 | 361      | (78)     | (21.6) |
| Risk management and insurance fees     | 176                                 | 249      | (73)     | (29.3) |
| Net gain on sale of securities         | 119                                 | —        | 119      | *      |
| Income on company-owned life insurance | 95                                  | 99       | (4)      | (4.0)  |
| Total non-interest income              | \$ 8,788                            | \$ 6,638 | \$ 2,150 | 32.4 % |

  

| (Dollars in thousands)                 | Nine Months Ended<br>September 30, |           | Change   |        |
|--|------------------------------------|-----------|----------|--------|
|  | 2019                               | 2018      | \$       | %      |
| <b>Non-interest income:</b>            |                                    |           |          |        |
| Trust and investment management fees   | \$ 14,186                          | \$ 14,413 | \$ (227) | (1.6)% |
| Net gain on mortgage loans sold        | 8,009                              | 3,769     | 4,240    | 112.5  |
| Bank fees                              | 912                                | 1,426     | (514)    | (36.0) |
| Risk management and insurance fees     | 838                                | 916       | (78)     | (8.5)  |
| Net gain on sale of securities         | 119                                | —         | 119      | *      |
| Income on company-owned life insurance | 284                                | 298       | (14)     | (4.7)  |
| Total non-interest income              | \$ 24,348                          | \$ 20,822 | \$ 3,526 | 16.9 % |

\* Not meaningful

*Trust and investment management fees*—For the three months ended September 30, 2019 compared to the same period in 2018, our trust and investment management fees in the Wealth Management and Capital Management segments remained consistent. For the nine months ended September 30, 2019 compared to the same period in 2018, our trust and investment management fees decreased within our Capital Management segment by \$0.2 million, or 8.5%. The decrease for the nine months ended September 30, 2019 compared to the same period in 2018 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 September 30, 2019 compared to the same period in 2018, our net gain on mortgage loans sold increased by \$2.1 million, or 184.0%, to \$3.3 million. For the three months ended September 30, 2019 and 2018, our origination volume was \$214.5 million and \$101.0 million, respectively. For the nine months ended September 30, 2019 compared to the same period in 2018, our net gain on mortgage loans sold increased by \$4.2 million, or 112.5%, to \$8.0 million. For the nine months ended September 30, 2019 and 2018, our origination volume was \$422.8 million and \$310.6 million, respectively. The net gain on sales of loans will fluctuate with the amount and type of loans sold and market conditions. The increase in origination volume for the three and nine month period was primarily related to a strong residential real estate market in our footprint, lower market rates and management's commitment and ability to capitalize on the mortgage environment.

*Net gain on sale of securities*—For the three and nine months ended September 30, 2019 our net gain on sale of securities was \$0.1 million. The Company did not sell securities during the three and nine months ended September 30, 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 and nine months ended September 30, 2019, we recognized \$0.2 million and \$0.8 million of risk management fees as compared to \$0.2 million and \$0.9 million for the same period in 2018, respectively. The slight year to date decrease was attributed primarily to a decrease in the average size of client policies placed.

#### *Provision for Credit Losses*

For the nine months ended September 30, 2019, we recorded \$0.2 million of provision for credit losses, primarily due to an increase in substandard loans. 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. For the three months ended September 30, 2019, we recorded \$0.1 million of provision for credit losses primarily driven by an increase in substandard loans.

#### 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<br>September 30, |                  | Change          |               |
|---|-------------------------------------|------------------|-----------------|---------------|
|   | 2019                                | 2018             | \$              | %             |
| Non-interest expense:                   |                                     |                  |                 |               |
| Salaries and employee benefits          | \$ 8,504                            | \$ 7,221         | \$ 1,283        | 17.8 %        |
| Occupancy and equipment                 | 1,388                               | 1,427            | (39)            | (2.7)         |
| Professional services                   | 745                                 | 805              | (60)            | (7.5)         |
| Technology and information systems      | 961                                 | 965              | (4)             | (0.4)         |
| Data processing                         | 854                                 | 697              | 157             | 22.5          |
| Marketing                               | 272                                 | 274              | (2)             | (0.7)         |
| Amortization of other intangible assets | 52                                  | 208              | (156)           | (75.0)        |
| Goodwill impairment                     | —                                   | —                | —               | *             |
| Other                                   | 666                                 | 579              | 87              | 15.0          |
| Total non-interest expense              | <u>\$ 13,442</u>                    | <u>\$ 12,176</u> | <u>\$ 1,266</u> | <u>10.4 %</u> |

  

| (Dollars in thousands)                  | Nine Months Ended<br>September 30, |                  | Change          |              |
|---|------------------------------------|------------------|-----------------|--------------|
|   | 2019                               | 2018             | \$              | %            |
| Non-interest expense:                   |                                    |                  |                 |              |
| Salaries and employee benefits          | \$ 23,821                          | \$ 23,061        | \$ 760          | 3.3 %        |
| Occupancy and equipment                 | 4,193                              | 4,439            | (246)           | (5.5)        |
| Professional services                   | 2,557                              | 2,637            | (80)            | (3.0)        |
| Technology and information systems      | 3,046                              | 3,028            | 18              | 0.6          |
| Data processing                         | 2,282                              | 2,024            | 258             | 12.7         |
| Marketing                               | 991                                | 875              | 116             | 13.3         |
| Amortization of other intangible assets | 366                                | 668              | (302)           | (45.2)       |
| Goodwill impairment                     | 1,572                              | —                | 1,572           | *            |
| Other                                   | 1,873                              | 1,814            | 59              | 3.3          |
| Total non-interest expense              | <u>\$ 40,701</u>                   | <u>\$ 38,546</u> | <u>\$ 2,155</u> | <u>5.6 %</u> |

\* Not meaningful

The increase in non-interest expense of 10.4% to \$13.4 million for the three months ended September 30, 2019 was primarily due to an increase in salaries and employee benefits. The increase in non-interest expense of 5.6% to \$40.7 million for the nine months ended September 30, 2019 was primarily attributable to an increase in salaries and employee benefits along with a goodwill impairment charge recorded in the amount of \$1.6 million during the second quarter of 2019. The increase in salary and employee benefits was primarily driven by \$0.5 million increase in non-operating equity compensation expenses for performance related earnout payouts as a result of the September 2017 acquisition of EMC Holdings, LLC ("EMC") along with \$0.4 million of higher incentive compensation accruals.

#### Income Tax

During the three and nine months ended September 30, 2019, the Company recorded an income tax provision of \$0.8 million and \$1.9 million, respectively, reflecting an effective tax rate of 24.5% and 25.5%, 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 September 30, 2019 |                    |          |              | Nine Months Ended September 30, 2019 |                    |          |              |
|----------------------------|---------------------------------------|--------------------|----------|--------------|--------------------------------------|--------------------|----------|--------------|
|                            | Wealth Management                     | Capital Management | Mortgage | Consolidated | Wealth Management                    | Capital Management | Mortgage | Consolidated |
| (Dollars in thousands)     |                                       |                    |          |              |                                      |                    |          |              |
| Income <sup>(1)</sup>      | \$ 12,554                             | \$ 776             | \$ 3,298 | \$ 16,628    | \$ 37,611                            | \$ 2,339           | \$ 8,053 | \$ 48,003    |
| Income (loss) before taxes | \$ 1,846                              | \$ 53              | \$ 1,287 | \$ 3,186     | \$ 5,774                             | \$ (1,618)         | \$ 3,146 | \$ 7,302     |
| Profit margin              | 14.7 %                                | 6.8 %              | 39.0 %   | 19.2 %       | 15.4 %                               | (69.2)%            | 39.1 %   | 15.2 %       |

  

|                            | Three Months Ended September 30, 2018 |                    |          |              | Nine Months Ended September 30, 2018 |                    |          |              |
|----------------------------|---------------------------------------|--------------------|----------|--------------|--------------------------------------|--------------------|----------|--------------|
|                            | Wealth Management                     | Capital Management | Mortgage | Consolidated | Wealth Management                    | Capital Management | Mortgage | Consolidated |
| (Dollars in thousands)     |                                       |                    |          |              |                                      |                    |          |              |
| Income <sup>(1)</sup>      | \$ 12,383                             | \$ 850             | \$ 1,175 | \$ 14,408    | \$ 37,351                            | \$ 2,556           | \$ 3,809 | \$ 43,716    |
| Income (loss) before taxes | \$ 2,385                              | \$ 114             | \$ (267) | \$ 2,232     | \$ 6,549                             | \$ (719)           | \$ (660) | \$ 5,170     |
| Profit margin              | 19.3 %                                | 13.4 %             | (22.7)%  | 15.5 %       | 17.5 %                               | (28.1)%            | (17.3)%  | 11.8 %       |

(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 September 30, |              | \$ Change  | % Change |
|---------------------------------------|--|--------------|------------|----------|
|                                       | 2019   | 2018         |            |          |
| (Dollars in thousands)                |  |              |            |          |
| Total interest income                 | \$ 11,473  | \$ 9,940     | \$ 1,533   | 15.4 %   |
| Total interest expense                | 3,533  | 2,152        | 1,381      | 64.2     |
| Provision for loan losses             | 100  | 18           | 82         | 455.6    |
| Net interest income                   | 7,840  | 7,770        | 70         | 0.9      |
| Non-interest income                   | 4,714  | 4,613        | 101        | 2.2      |
| Total income                          | 12,554   | 12,383       | 171        | 1.4      |
| Depreciation and amortization expense | 274  | 323          | (49)       | (15.2)   |
| All other non-interest expense        | 10,434   | 9,675        | 759        | 7.8      |
| Income before income tax              | \$ 1,846   | \$ 2,385     | \$ (539)   | (22.6)%  |
| Goodwill                              | \$ 15,994  | \$ 15,994    | \$ —       | — %      |
| Identifiable assets                   | \$ 1,195,340                                       | \$ 1,022,436 | \$ 172,904 | 16.9 %   |

  

|   | As of and For the Nine Months Ended September 30, |              | \$ Change  | % Change |
|---|---|--------------|------------|----------|
|   | 2019  | 2018         |            |          |
| (Dollars in thousands)                  |   |              |            |          |
| Total interest income                   | \$ 33,698   | \$ 28,451    | \$ 5,247   | 18.4 %   |
| Total interest expense                  | 9,827   | 5,726        | 4,101      | 71.6     |
| Provision for (recovery of) loan losses | 216   | (169)        | 385        | (227.8)  |
| Net interest income                     | 23,655  | 22,894       | 761        | 3.3      |
| Non-interest income                     | 13,956  | 14,457       | (501)      | (3.5)    |
| Total income                            | 37,611  | 37,351       | 260        | 0.7      |
| Depreciation and amortization expense   | 902   | 963          | (61)       | (6.3)    |
| All other non-interest expense          | 30,935  | 29,839       | 1,096      | 3.7      |
| Income before income tax                | \$ 5,774  | \$ 6,549     | \$ (775)   | (11.8)%  |
| Goodwill                                | \$ 15,994   | \$ 15,994    | \$ —       | — %      |
| Identifiable assets                     | \$ 1,195,340                                      | \$ 1,022,436 | \$ 172,904 | 16.9 %   |

The Wealth Management segment reported income before income tax of \$1.8 million and \$5.8 million for the three and nine months ended September 30, 2019, respectively, compared to \$2.4 million and \$6.5 million, respectively, for the same periods in 2018. The decrease for the three month period is primarily related to an increase in operating

expenses, partially offset by an increase in net interest income driven by an increase in the average balance and yield on interest-earning assets which was then offset partially by an increase in average funding balances and cost of funds. The decrease for the nine month period is primarily related to a decrease in bank fees and trust and investment management fees and an increase in operating expenses, partially offset by an increase in net interest income driven by an increase in the average balance and yield on interest-earning assets which was offset partially by an increase in average funding balances and cost of funds. During the three and nine months ended September 30, 2019 average loans increased \$79.6 million and \$89.6 million and the yield on total interest-earning assets increased to 4.26% from 4.20% and to 4.27% from 4.10%, compared to the same periods in 2018.

### Capital Management

| (Dollars in thousands)                | As of and For the Three Months<br>Ended September 30, |          |            |          |
|---------------------------------------|---|----------|------------|----------|
|                                       | 2019  | 2018     | \$ Change  | % Change |
| Total interest income                 | \$ —  | \$ —     | \$ —       | — %      |
| Total interest expense                | —   | —        | —          | —        |
| Provision for loan losses             | —   | —        | —          | —        |
| Net interest income                   | —   | —        | —          | —        |
| Non-interest income                   | 776   | 850      | (74)       | (8.7)    |
| Total income                          | 776   | 850      | (74)       | (8.7)    |
| Depreciation and amortization expense | 22  | 130      | (108)      | (83.0)   |
| All other non-interest expense        | 701   | 606      | 95         | 15.7     |
| Income before income tax              | \$ 53   | \$ 114   | \$ (61)    | (53.5)%  |
| Goodwill                              | \$ 3,692  | \$ 8,817 | \$ (5,125) | (58.1)%  |
| Assets held for sale                  | 3,553   | —        | 3,553      | *        |
| Identifiable assets                   | \$ 8,528  | \$ 9,853 | \$ (1,325) | (13.4)%  |

  

| (Dollars in thousands)                | As of and For the Nine Months<br>Ended September 30, |          |            |          |
|---------------------------------------|--|----------|------------|----------|
|                                       | 2019   | 2018     | \$ Change  | % Change |
| Total interest income                 | \$ —   | \$ —     | \$ —       | — %      |
| Total interest expense                | —  | —        | —          | —        |
| Provision for loan losses             | —  | —        | —          | —        |
| Net interest income                   | —  | —        | —          | —        |
| Non-interest income                   | 2,339  | 2,556    | (217)      | (8.5)    |
| Total income                          | 2,339  | 2,556    | (217)      | (8.5)    |
| Depreciation and amortization expense | 248  | 393      | (145)      | (37.0)   |
| All other non-interest expense        | 3,709 (1)  | 2,882    | 827        | 28.7     |
| Income (loss) before income tax       | \$ (1,618)   | \$ (719) | \$ (899)   | 125.0 %  |
| Goodwill                              | \$ 3,692   | \$ 8,817 | \$ (5,125) | (58.1)%  |
| Assets held for sale                  | 3,553  | —        | 3,553      | *        |
| Identifiable assets                   | \$ 8,528   | \$ 9,853 | \$ (1,325) | (13.4)%  |

\* Not meaningful

(1) Includes goodwill impairment charge of \$1.6 million.

The Capital Management segment reported income before income tax of \$0.1 million for the three months ended September 30, 2019 and 2018. For the nine months ended September 30, 2019 and 2018 the Capital Management segment reported a loss before income tax of \$1.6 million and \$0.7 million. This was primarily driven by a goodwill impairment charge of \$1.6 million and a decrease in trust and investment management fees, offset partially by a decrease in operating expenses related 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<br>Ended September 30, |           | \$ Change | % Change |
|---------------------------------------|---|-----------|-----------|----------|
|                                       | 2019  | 2018      |           |          |
| Total interest income                 | \$ —  | \$ —      | \$ —      | —%       |
| Total interest expense                | —   | —         | —         | —        |
| Provision for loan losses             | —   | —         | —         | —        |
| Net interest income                   | —   | —         | —         | —        |
| Non-interest income                   | 3,298   | 1,175     | 2,123     | 180.7    |
| Total income                          | 3,298   | 1,175     | 2,123     | 180.7    |
| Depreciation and amortization expense | 55  | 104       | (49)      | (47.1)   |
| All other non-interest expense        | 1,956   | 1,338     | 618       | 46.2     |
| Income (loss) before income tax       | \$ 1,287  | \$ (267)  | \$ 1,554  | (582.0)% |
| Goodwill                              | \$ —  | \$ —      | \$ —      | —%       |
| Identifiable assets                   | \$ 68,057   | \$ 19,238 | \$ 48,819 | 253.8%   |

  

| (Dollars in thousands)                | As of and For the Nine Months<br>Ended September 30, |           | \$ Change | % Change |
|---------------------------------------|--|-----------|-----------|----------|
|                                       | 2019   | 2018      |           |          |
| Total interest income                 | \$ —   | \$ —      | \$ —      | —%       |
| Total interest expense                | —  | —         | —         | —        |
| Provision for loan losses             | —  | —         | —         | —        |
| Net interest income                   | —  | —         | —         | —        |
| Non-interest income                   | 8,053  | 3,809     | 4,244     | 111.4    |
| Total income                          | 8,053  | 3,809     | 4,244     | 111.4    |
| Depreciation and amortization expense | 197  | 351       | (154)     | (43.9)   |
| All other non-interest expense        | 4,710  | 4,118     | 592       | 14.4     |
| Loss before income tax                | \$ 3,146   | \$ (660)  | \$ 3,806  | (576.7)% |
| Goodwill                              | \$ —   | \$ —      | \$ —      | —%       |
| Identifiable assets                   | \$ 68,057  | \$ 19,238 | \$ 48,819 | 253.8%   |

The Mortgage segment reported income before income tax of \$1.3 million and \$3.1 million for the three and nine months ended September 30, 2019, compared to a loss of \$0.3 million and \$0.7 million, for the same periods in 2018. The overall increase in non-interest income was primarily related to an increase in origination volume due to a strong residential real estate market in our footprint, lower market rates and management's commitment and the ability to capitalize on the mortgage segment as evidenced in the addition of mortgage loan originators.

## Financial Condition

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

| <i>(Dollars in thousands)</i>                     | September 30,<br>2019 | December 31,<br>2018 | \$ Change         | % Change      |
|---|-----------------------|----------------------|-------------------|---------------|
| <b>Balance Sheet Data:</b>                        |                       |                      |                   |               |
| Cash and cash equivalents                         | \$ 146,176            | \$ 73,357            | \$ 72,819         | 99.3 %        |
| Investments                                       | 61,491                | 43,695               | 17,796            | 40.7          |
| Loans   | 926,586               | 893,966              | 32,620            | 3.6           |
| Allowance for loan losses                         | (7,675)               | (7,451)              | (224)             | 3.0           |
| Loans, net of allowance                           | 918,911               | 886,515              | 32,396            | 3.7           |
| Mortgage loans held for sale                      | 69,231                | 14,832               | 54,399            | 366.8         |
| Goodwill & other intangible assets, net           | 19,722                | 25,213               | (5,491)           | (21.8)        |
| Company-owned life insurance                      | 14,993                | 14,709               | 284               | 1.9           |
| Other assets                                      | 37,848                | 26,003               | 11,845            | 45.6          |
| Assets held for sale                              | 3,553                 | —                    | 3,553             | *             |
| <b>Total assets</b>                               | <b>\$ 1,271,925</b>   | <b>\$ 1,084,324</b>  | <b>\$ 187,601</b> | <b>17.3 %</b> |
| Deposits  | \$ 1,108,904          | \$ 937,758           | \$ 171,146        | 18.3 %        |
| Borrowings  | 16,560                | 21,560               | (5,000)           | (23.2)        |
| Other liabilities                                 | 20,618                | 8,131                | 12,487            | 153.6         |
| Liabilities held for sale                         | 111                   | —                    | 111               | *             |
| <b>Total liabilities</b>                          | <b>1,146,193</b>      | <b>967,449</b>       | <b>178,744</b>    | <b>18.5</b>   |
| Total shareholders' equity                        | 125,732               | 116,875              | 8,857             | 7.6           |
| <b>Total liabilities and shareholders' equity</b> | <b>\$ 1,271,925</b>   | <b>\$ 1,084,324</b>  | <b>\$ 187,601</b> | <b>17.3 %</b> |

\* Not meaningful

Cash and cash equivalents increased by \$72.8 million, or 99.3%, to \$146.2 million at September 30, 2019 compared to December 31, 2018. During the same period, investments increased by \$17.8 million, or 40.7%, to \$61.5 million at September 30, 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 \$32.6 million, or 3.6%, to \$926.6 million at September 30, 2019 compared to December 31, 2018. The increase was primarily due to growth in our all major loan categories with the exception of Non-Owner Occupied CRE and Commercial and Industrial.

Mortgage loans held for sale increased \$54.4 million, or 366.8%, to \$69.2 million at September 30, 2019 compared to December 31, 2018. This increase corresponds to the increase in mortgage origination volume as noted in the Mortgage segment activity.

Goodwill and other intangible assets, net decreased by \$5.5 million from December 31, 2018 due to a goodwill impairment charge in the amount of \$1.6 million in the Capital Management segment, \$3.6 million moved to assets held for sale also in the Capital Management segment and \$0.4 million of intangible amortization.

Our annual goodwill impairment assessment date for the Company's segments 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 segment's fair value as well as mitigating events or conditions. The assessment of each segment 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.

During the second quarter 2019, we received an offer to sell a portion of our Capital Management segment. We determined it was more likely than not that we would analyze and dispose of a portion of the segment. Based on this analysis, the Company proceeded to perform an interim impairment test for Capital Management segment. As part of the qualitative assessment, it did indicate that it was more likely than not that the carrying value of the Capital Management segment exceeded its fair value. Therefore, the Company proceeded to Step 1 of the interim goodwill impairment test.

To estimate the fair value of our segments, an independent valuation specialist assisted us and we used an income approach, specifically a discounted cash flow methodology, and a market approach. The discounted cash flow methodology includes assumptions for forecasted revenues, growth rates, discount rates, and market multiples, which all require significant judgment and estimates by management and are inherently uncertain. The fair value did not exceed the carrying value of the Capital Management segment at the time of testing. During the first half of 2019, the growth in revenue had not been realized at previously forecasted levels for the Capital Management segment. The Company had

focused on revenue growth in the more core areas in Wealth Management and Mortgage. Our outlook for the Capital Management segment had declined driven by the lower market penetration and slower growth in assets under management which has negatively impacted our near-term earnings outlook for this segment. As such, this had caused a downward revision for our forecast on current and projected cash flows for the Capital Management segment which resulted in a lower fair value.

Therefore, we conducted Step 2 of the goodwill impairment test for the Capital Management segment. As a result of our two step evaluation, we recorded a non-cash goodwill impairment loss of \$1.6 million for the second quarter 2019 in the Capital Management segment. As of September 30, 2019, there was \$3.7 million of goodwill remaining in the Capital Management segment.

As of September 30, 2019, there was an outstanding agreement with Lido Advisors, LCC for a portion of the Capital Management segment. As such, goodwill was allocated based on the relative fair value for the portion of the segment held for sale, in the amount of \$3.6 million, and was reclassified to assets held for sale at the end of the third quarter 2019. As of September 30, 2019, the remaining value of goodwill in the Capital Management segment was \$3.7 million. For events occurring after the period which pertain to this transaction see Note 17 – Subsequent Events.

See Note 4 - Goodwill of the accompanying Notes to Condensed Consolidated Financial Statements for additional information.

Other assets increased by \$11.8 million, or 45.6%, to \$37.8 million at September 30, 2019 compared to December 31, 2018. This was primarily related to the addition of a right of use asset upon the adoption of ASU 2016-02 on January 1, 2019 that is classified in other assets on the condensed consolidated balance sheet.

Total deposits increased \$171.1 million, or 18.3%, to \$1.11 billion at September 30, 2019 compared to December 31, 2018. Total interest-bearing deposits increased \$142.5 million, or 19.4%, to \$877.4 million and noninterest-bearing deposits increased \$28.7 million, or 14.1%, to \$231.5 million, during this period.

Money market deposit accounts increased \$130.9 million, or 26.7%, to \$620.4 million at September 30, 2019 compared to December 31, 2018. Time deposit accounts decreased \$8.3 million, or 4.6%, from December 31, 2018 to \$170.5 million at September 30, 2019. Negotiable order of withdrawal, or NOW accounts, increased \$18.2 million, or 28.0%, to \$83.0 million from December 31, 2018 to September 30, 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 increase in NOW accounts was attributed to an increase in organic growth related to our deposit initiatives.

Total borrowings decreased \$5.0 million, or 23.2%, to \$16.6 million at September 30, 2019 compared to December 31, 2018. The decrease was attributable to a decrease in our Federal Home Loan Bank (“FHLB”) line of credit at September 30, 2019 compared to December 31, 2018. Total shareholders’ equity increased \$8.9 million, or 7.6%, from December 31, 2018 to \$125.7 million at September 30, 2019. The increase is primarily due to net income of \$5.4 million and a \$1.8 million increase in the unrealized gain on our available-for-sale investments primarily due to changes in market rates.



## Assets Under Management

| (Dollars in millions)                                       | Three Months Ended<br>September 30, |                 | Nine Months Ended<br>September 30, |                 |
|---|-------------------------------------|-----------------|------------------------------------|-----------------|
|   | 2019                                | 2018            | 2019                               | 2018            |
| <b>Managed Trust Balance at Beginning of Period</b>         | <b>\$ 1,670</b>                     | <b>\$ 1,442</b> | <b>\$ 1,380</b>                    | <b>\$ 1,438</b> |
| New relationships   | 2                                   | 2               | 43                                 | 5               |
| Closed relationships  | (1)                                 | (5)             | (2)                                | (9)             |
| Contributions   | 4                                   | 12              | 14                                 | 43              |
| Withdrawals   | (12)                                | (17)            | (100)                              | (131)           |
| Market change, net  | 119                                 | 84              | 447                                | 172             |
| <b>Ending Balance</b>                                       | <b>\$ 1,782</b>                     | <b>\$ 1,518</b> | <b>\$ 1,782</b>                    | <b>\$ 1,518</b> |
| Yield*  | 0.17 %                              | 0.17 %          | 0.16 %                             | 0.18 %          |
| <b>Directed Trust Balance at Beginning of Period</b>        | <b>\$ 931</b>                       | <b>\$ 809</b>   | <b>\$ 789</b>                      | <b>\$ 714</b>   |
| New relationships   | 4                                   | —               | 132                                | 37              |
| Closed relationships  | —                                   | —               | —                                  | —               |
| Contributions   | 2                                   | 27              | 31                                 | 46              |
| Withdrawals   | (4)                                 | (8)             | (45)                               | (27)            |
| Market change, net  | 13                                  | (13)            | 39                                 | 45              |
| <b>Ending Balance</b>                                       | <b>\$ 946</b>                       | <b>\$ 815</b>   | <b>\$ 946</b>                      | <b>\$ 815</b>   |
| Yield*  | 0.07 %                              | 0.07 %          | 0.07 %                             | 0.07 %          |
| <b>Investment Agency Balance at Beginning of Period</b>     | <b>\$ 1,911</b>                     | <b>\$ 1,923</b> | <b>\$ 1,846</b>                    | <b>\$ 2,100</b> |
| New relationships   | 13                                  | 67              | 44                                 | 115             |
| Closed relationships  | —                                   | (26)            | (56)                               | (206)           |
| Contributions   | 37                                  | 70              | 110                                | 167             |
| Withdrawals   | (64)                                | (75)            | (210)                              | (222)           |
| Market change, net  | 23                                  | 41              | 186                                | 46              |
| <b>Ending Balance</b>                                       | <b>\$ 1,920</b>                     | <b>\$ 2,000</b> | <b>\$ 1,920</b>                    | <b>\$ 2,000</b> |
| Yield*  | 0.69 %                              | 0.70 %          | 0.68 %                             | 0.75 %          |
| <b>Custody Balance at Beginning of Period</b>               | <b>\$ 460</b>                       | <b>\$ 417</b>   | <b>\$ 356</b>                      | <b>\$ 374</b>   |
| New relationships   | 1                                   | 1               | 11                                 | 2               |
| Closed relationships  | —                                   | —               | (2)                                | (7)             |
| Contributions   | 3                                   | 18              | 80                                 | 116             |
| Withdrawals   | (5)                                 | (35)            | (51)                               | (101)           |
| Market change, net  | 12                                  | 14              | 77                                 | 31              |
| <b>Ending Balance</b>                                       | <b>\$ 471</b>                       | <b>\$ 415</b>   | <b>\$ 471</b>                      | <b>\$ 415</b>   |
| Yield*  | 0.03 %                              | 0.04 %          | 0.03 %                             | 0.03 %          |
| <b>401(k)/Retirement Balance at Beginning of Period</b>     | <b>\$ 997</b>                       | <b>\$ 825</b>   | <b>\$ 864</b>                      | <b>\$ 748</b>   |
| New relationships   | —                                   | 26              | 6                                  | 78              |
| Closed relationships  | (6)                                 | —               | (26)                               | (30)            |
| Contributions   | —                                   | 22              | 60                                 | 73              |
| Withdrawals   | 2                                   | (16)            | (44)                               | (48)            |
| Market change, net  | 3                                   | 21              | 136                                | 57              |
| <b>Ending Balance<sup>(1)</sup></b>                         | <b>\$ 996</b>                       | <b>\$ 878</b>   | <b>\$ 996</b>                      | <b>\$ 878</b>   |
| Yield*  | 0.21 %                              | 0.19 %          | 0.22 %                             | 0.19 %          |
| <b>Total Assets Under Management at Beginning of Period</b> | <b>5,969</b>                        | <b>5,416</b>    | <b>5,235</b>                       | <b>5,374</b>    |
| New relationships   | 20                                  | 96              | 236                                | 237             |
| Closed relationships  | (7)                                 | (31)            | (86)                               | (252)           |
| Contributions   | 46                                  | 149             | 295                                | 445             |
| Withdrawals   | (83)                                | (151)           | (450)                              | (529)           |
| Market change, net  | 170                                 | 147             | 885                                | 351             |
| <b>Total Assets Under Management</b>                        | <b>\$ 6,115</b>                     | <b>\$ 5,626</b> | <b>\$ 6,115</b>                    | <b>\$ 5,626</b> |
| Yield*  | 0.32 %                              | 0.34 %          | 0.31 %                             | 0.36 %          |

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

(1) AUM shown is one period in arrears

Three months ended September 30, 2019 compared with the three months ended September 30, 2018. Assets under management increased \$146.0 million and \$210.0 million, or 2.4% and 3.9% for the three months ended September 30, 2019 and 2018, respectively. The increase during the three months ended September 30, 2019 was primarily related to market gains. The increase during the three months ended September 30, 2018 was primarily related to market gains and contributions. The decrease in yield for the three months ended September 30, 2019 compared to September 30, 2018 is primarily related to a decline in yield on investment agency balances and a mix shift in overall asset balances.

The nine months ended September 30, 2019 compared with the nine months ended September 30, 2018. Assets under management increased \$880.0 million and \$252.0 million, or 16.8% and 4.7% for the nine months ended September 30, 2019 and 2018, respectively. The increase during the nine months ended September 30, 2019 was primarily related to market gains. The increase during the nine months ended September 30, 2018 was primarily related to large contributions and market gains offset by closed accounts and withdrawals. The decrease in yield for the nine months ended September 30, 2019 compared to September 30, 2018 is primarily related to a decline in yield on investment agency balances and a mix shift in overall asset balances.

#### 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, 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 September 30, 2019:

|  | September 30, 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             | \$ 5                   | \$ —                    | \$ 255     |
| Government National Mortgage Association mortgage-backed securities—residential ("GNMA")     | 45,439             | 389                    | (93)                    | 45,735     |
| Federal National Mortgage Association mortgage-backed securities—residential ("FNMA")        | 3,326              | 10                     | (27)                    | 3,309      |
| Securities issued by U.S. government sponsored entities and agencies                         | —                  | —                      | —                       | —          |
| Corporate collateralized mortgage obligations ("CMO") and mortgage-backed securities ("MBS") | 12,140             | 77                     | (25)                    | 12,192     |
| Total securities available-for-sale  | \$ 61,155          | \$ 481                 | \$ (145)                | \$ 61,491  |

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 September 30, 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   | —                                 | —                      | —                 | —                      | —                 | —                      | 45,439          | 1.84                   |
| FNMA   | —                                 | —                      | —                 | —                      | —                 | —                      | 3,326           | 0.14                   |
| Securities issued by U.S. government sponsored entities and agencies | —                                 | —                      | —                 | —                      | —                 | —                      | —               | —                      |
| Corporate CMO and MBS  | —                                 | —                      | —                 | —                      | —                 | —                      | 12,140          | 0.65                   |
| Total available-for-sale   | \$ —                              | — %                    | \$ 250            | 0.01 %                 | \$ —              | — %                    | \$ 60,905       | 2.63 %                 |

|  | 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 September 30, 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 September 30, 2019 and December 31, 2018, we had mortgage loans held for sale of \$69.2 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:

| (Dollars in thousands)                         | September 30, 2019 |            | December 31, 2018 |            |
|--|--------------------|------------|-------------------|------------|
|  | Amount             | % of Total | Amount            | % of Total |
| Cash, Securities and Other                     | \$ 146,622         | 15.9 %     | \$ 114,165        | 12.8 %     |
| Construction and Development                   | 42,059             | 4.6        | 31,897            | 3.5        |
| 1 - 4 Family Residential                       | 366,238            | 39.6       | 350,852           | 39.3       |
| Non-Owner Occupied CRE                         | 138,753            | 15.0       | 173,741           | 19.5       |
| Owner Occupied CRE                             | 119,497            | 12.9       | 108,480           | 12.2       |
| Commercial and Industrial                      | 111,187            | 12.0       | 113,660           | 12.7       |
| Total loans held for investment <sup>(1)</sup> | \$ 924,356         | 100.0 %    | \$ 892,795        | 100.0 %    |
| Mortgage loans held for sale                   | \$ 69,231          |            | \$ 14,832         |            |

(1) Loans held for investment exclude deferred costs, net of \$2.2 million and \$1.2 million as of September 30, 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 September 30, 2019 |                        |                  |            |
|-------------------------------|--------------------------|------------------------|------------------|------------|
|                               | One Year or Less         | One Through Five Years | After Five Years | Total      |
| <i>(Dollars in thousands)</i> |                          |                        |                  |            |
| Cash, Securities and Other    | \$ 3,089                 | \$ 130,346             | \$ 13,187        | \$ 146,622 |
| Construction and Development  | —                        | 40,508                 | 1,551            | 42,059     |
| 1 - 4 Family Residential      | 6,013                    | 126,393                | 233,832          | 366,238    |
| Non-Owner Occupied CRE        | 902                      | 92,512                 | 45,339           | 138,753    |
| Owner Occupied CRE            | —                        | 38,262                 | 81,235           | 119,497    |
| Commercial and Industrial     | 4,379                    | 85,152                 | 21,656           | 111,187    |
| Total loans                   | \$ 14,383                | \$ 513,173             | \$ 396,800       | \$ 924,356 |
| Amounts with fixed rates      | \$ 4,807                 | \$ 268,540             | \$ 138,432       | \$ 411,779 |
| Amounts with floating rates   | 9,576                    | 244,633                | 258,368          | 512,577    |
| Total loans                   | \$ 14,383                | \$ 513,173             | \$ 396,800       | \$ 924,356 |

  

|                               | 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 September 30, 2019 and 2018, the amount of lost interest for non-accrual loans was \$0.1 million and \$0.1 million, respectively. For the nine months ended September 30, 2019 and 2018, the amount of lost interest for non-accrual loans was \$0.3 million and \$0.2 million, respectively.

We had \$14.6 million in non-performing assets as of September 30, 2019 compared to \$19.7 million as of December 31, 2018. The \$5.1 million decrease in our non-performing assets was primarily related to a principal curtailment on a Commercial and Industrial loan for \$0.7 million and principal paydowns received on a Cash, Securities, and Other loan for \$6.2 million, partially offset by an increase in another Commercial and Industrial loan due to an extension of credit for \$1.6 million to a borrower for operational needs. As of September 30, 2019, these loans were classified as TDRs.

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

| <i>(Dollars in thousands)</i>                               | September 30,<br>2019 | December 31,<br>2018 |
|---|-----------------------|----------------------|
| Non-accrual loans by category                               |                       |                      |
| Cash, Securities and Other                                  | \$ 5,264              | \$ 11,252            |
| Construction and Development                                | —                     | —                    |
| 1 - 4 Family Residential                                    | —                     | —                    |
| Non-Owner Occupied CRE                                      | —                     | —                    |
| Owner Occupied CRE  | —                     | —                    |
| Commercial and Industrial                                   | 1,035                 | 1,735                |
| Total non-accrual loans                                     | 6,299                 | 12,987               |
| TDRs still accruing   | 6,468                 | 4,848                |
| Accruing loans 90 or more days past due                     | 1,213                 | 1,217                |
| Total non-performing loans                                  | 13,980                | 19,052               |
| OREO  | 658                   | 658                  |
| Total non-performing assets                                 | \$ 14,638             | \$ 19,710            |
| Ratio of non-performing loans to total loans <sup>(1)</sup> | 1.51 %                | 2.13 %               |
| Ratio of non-performing assets to total assets              | 1.15 %                | 1.82 %               |
| Allowance as a percentage of non-performing loans           | 54.90 %               | 39.11 %              |

(1) Excludes mortgage loans held for sale of \$69.2 million and \$14.8 million as of September 30, 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 September 30, 2019 and December 31, 2018 non-performing loans of \$14.0 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 September 30, 2019 |                    |             |            | As of December 31, 2018 |                    |             |            |
|------------------------------|--------------------------|--------------------|-------------|------------|-------------------------|--------------------|-------------|------------|
|                              | Pass                     | Special<br>Mention | Substandard | Total      | Pass                    | Special<br>Mention | Substandard | Total      |
| Cash, Securities and Other   | \$ 141,358               | \$ —               | \$ 5,264    | \$ 146,622 | \$ 102,913              | \$ —               | \$ 11,252   | \$ 114,165 |
| Construction and Development | 42,059                   | —                  | —           | 42,059     | 31,897                  | —                  | —           | 31,897     |
| 1 - 4 Family Residential     | 359,030                  | —                  | 7,208       | 366,238    | 349,635                 | —                  | 1,217       | 350,852    |
| Non-Owner Occupied CRE       | 137,582                  | 1,171              | —           | 138,753    | 165,164                 | 8,117              | 460         | 173,741    |
| Owner Occupied CRE           | 119,497                  | —                  | —           | 119,497    | 108,480                 | —                  | —           | 108,480    |
| Commercial and Industrial    | 95,371                   | —                  | 15,816      | 111,187    | 100,929                 | —                  | 12,731      | 113,660    |
| Total                        | \$ 894,897               | \$ 1,171           | \$ 28,288   | \$ 924,356 | \$ 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<br>Three Months Ended September 30, |            | As of and for the<br>Nine Months Ended September 30, |            |
|---|---|------------|--|------------|
|   | 2019  | 2018       | 2019   | 2018       |
| Average loans outstanding <sup>(1)(2)</sup>                         | \$ 937,260  | \$ 857,676 | \$ 928,112   | \$ 838,525 |
| Gross loans outstanding at end of period <sup>(3)</sup>             | \$ 926,586  | \$ 857,317 | \$ 926,586   | \$ 857,317 |
| Allowance for loan losses at beginning of period                    | \$ 7,575  | \$ 7,100   | \$ 7,451   | \$ 7,287   |
| Provision for (recovery of) loan losses                             | 100   | 18         | 216  | (169)      |
| 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  | —   | —          | 8  | —          |
| Construction and Development  | —   | —          | —  | —          |
| 1 - 4 Family Residential  | —   | —          | —  | —          |
| Non-Owner Occupied CRE  | —   | —          | —  | —          |
| Owner Occupied CRE  | —   | —          | —  | —          |
| Commercial and Industrial   | —   | —          | —  | —          |
| Total recoveries  | —   | —          | 8  | —          |
| Net charge-offs (recoveries)  | —   | —          | (8)  | —          |
| Allowance for loan losses at end of period                          | \$ 7,675  | \$ 7,118   | \$ 7,675   | \$ 7,118   |
| Ratio of allowance to end of period loan                            | 0.83 %  | 0.83 %     | 0.83 %   | 0.83 %     |
| Ratio of net charge-offs (recovery) to average loans <sup>(1)</sup> | — %   | — %        | (—) %  | — %        |

(1) Average balances are average daily balances.

(2) Excludes average outstanding balances of mortgage loans held for sale of \$52.5 million and \$22.3 million for the three months ended September 30, 2019 and 2018 and \$32.6 million and \$24.1 million for the nine months ended September 30, 2019 and 2018, respectively.

(3) Excludes mortgage loans held for sale of \$69.2 million and \$19.2 million as of September 30, 2019 and September 30, 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)          | September 30, 2019 |                           | December 31, 2018 |                           |
|---------------------------------|--------------------|---------------------------|-------------------|---------------------------|
|                                 | Amount             | % of Total <sup>(1)</sup> | Amount            | % of Total <sup>(1)</sup> |
| Cash, Securities and Other      | \$ 1,307           | 15.9 %                    | \$ 764            | 12.8 %                    |
| Construction and development    | 308                | 4.6                       | 232               | 3.5                       |
| 1 - 4 Family Residential        | 2,677              | 39.6                      | 2,552             | 39.3                      |
| Non-Owner Occupied CRE          | 1,018              | 15.0                      | 1,264             | 19.5                      |
| Owner Occupied CRE              | 876                | 12.9                      | 789               | 12.2                      |
| Commercial and Industrial       | 1,489              | 12.0                      | 1,850             | 12.7                      |
| Total allowance for loan losses | \$ 7,675           | 100.0 %                   | \$ 7,451          | 100.0 %                   |

(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 September 30, 2019 increased \$0.5 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 \$171.1 million, or 18.3%, to \$1.11 billion at September 30, 2019 from December 31, 2018. Total average deposits for the three months ended September 30, 2019 were \$1.0 billion, an increase of \$180.3 million, or 20.9%, compared to \$861.9 million as of September 30, 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 was driven primarily by an increase in market rates and 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 Months Ended September 30, |              |                 |              |
|---|--|--------------|-----------------|--------------|
|   | 2019   |              | 2018            |              |
|   | Average Balance                                    | Average Rate | Average Balance | Average Rate |
| <b>Deposits</b>                               |  |              |                 |              |
| Money market deposit accounts                 | \$ 562,155   | 1.67 %       | \$ 416,581      | 1.18 %       |
| Demand deposit accounts                       | 87,434   | 0.43         | 64,753          | 0.21         |
| Certificates and other time deposits > \$250k | 70,797   | 2.12         | 86,116          | 1.50         |
| Certificates and other time deposits < \$250k | 103,255  | 2.13         | 71,548          | 1.08         |
| Total time deposits                           | 174,052  | 2.13         | 157,664         | 1.26         |
| Savings accounts                              | 2,849  | 0.28         | 1,509           | —            |
| Total interest-bearing deposits               | 826,490  | 1.63         | 640,507         | 1.10         |
| Noninterest-bearing accounts                  | 215,721  |              | 221,411         |              |
| Total deposits                                | \$ 1,042,211                                       | 1.29 %       | \$ 861,918      | 0.82 %       |



| (Dollars in thousands)                        | As of and For the Nine Months Ended September 30, |              |                 |              |
|---|---|--------------|-----------------|--------------|
|   | 2019  |              | 2018            |              |
|   | Average Balance                                   | Average Rate | Average Balance | Average Rate |
| <b>Deposits</b>                               |   |              |                 |              |
| Money market deposit accounts                 | \$ 526,103  | 1.66 %       | \$ 370,814      | 0.99 %       |
| Demand deposit accounts                       | 72,734  | 0.33         | 72,121          | 0.19         |
| Certificates and other time deposits > \$250k | 72,632  | 1.98         | 82,666          | 1.50         |
| Certificates and other time deposits < \$250k | 102,439   | 1.89         | 92,809          | 1.08         |
| Total time deposits                           | 175,071   | 1.93         | 175,475         | 1.12         |
| Savings accounts                              | 2,667   | 0.15         | 1,627           | —            |
| Total interest-bearing deposits               | 776,575   | 1.59         | 620,037         | 0.93         |
| Noninterest-bearing accounts                  | 225,512   |              | 216,836         |              |
| Total deposits                                | \$ 1,002,087                                      | 1.23 %       | \$ 836,873      | 0.69 %       |

Average noninterest-bearing deposits to average total deposits was 20.7% and 25.7% for the three months ended September 30, 2019 and 2018, respectively, and 22.5% and 25.9% for the nine months ended September 30, 2019 and 2018, respectively.

Our average cost of funds was 1.33% and 0.93% during the three months ended September 30, 2019 and 2018, respectively, and 1.28% and 0.85% during the nine months ended September 30, 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 1.63% during the three months ended September 30, 2019 compared to 1.10% for the three months ended September 30, 2018 and to 1.59% during the nine months ended September 30, 2019 compared to 0.93% for the nine months ended September 30, 2018. This increase is primarily due to an increase in market rates, deposit competition and a shift in deposit mix.

Money market deposit accounts as of September 30, 2019 were \$620.4 million, an increase of \$130.9 million, or 26.7%, compared to \$489.5 million as of December 31, 2018. Total time deposits as of September 30, 2019 were \$170.5 million, a decrease of \$8.3 million, or 4.6%, from December 31, 2018. 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 increase in NOW accounts was attributed to an increase in organic growth related to our deposit initiatives.

The following table represents the amount of certificates of deposit by time remaining until maturity as of September 30, 2019:

| (Dollars in thousands)   | As of September 30, 2019 |                     |                  |                 |            |
|--------------------------|--------------------------|---------------------|------------------|-----------------|------------|
|                          | Maturity Within:         |                     |                  |                 |            |
|                          | Three Months or Less     | Three to Six Months | Six to 12 Months | After 12 Months | Total      |
| Time, \$250,000 and over | \$ 14,064                | \$ 7,500            | \$ 18,593        | \$ 28,171       | \$ 68,328  |
| Other                    | 29,943                   | 9,028               | 53,680           | 9,478           | 102,129    |
| Total                    | \$ 44,007                | \$ 16,528           | \$ 72,273        | \$ 37,649       | \$ 170,457 |

#### Borrowings

We have short-term and long-term borrowing sources available to supplement deposits and meet our liquidity needs. As of September 30, 2019 and December 31, 2018, borrowings totaled \$16.6 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> | September 30, 2019 | December 31, 2018 |
|-------------------------------|--------------------|-------------------|
| <b>Borrowings</b>             |                    |                   |
| FHLB Topeka borrowings        | \$ 10,000          | \$ 15,000         |
| Subordinated notes            | 6,560              | 6,560             |
|                               | <u>\$ 16,560</u>   | <u>\$ 21,560</u>  |

#### *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 September 30, 2019 and December 31, 2018 amounted to \$536.9 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 \$366.2 million at September 30, 2019. As of September 30, 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<br>Nine Months Ended<br>September 30, 2019 |
|--|--|
| <b>Short-term borrowings:</b>                          |  |
| Maximum outstanding at any month-end during the period | \$ 30,925  |
| Balance outstanding at end of period                   | —  |
| Average outstanding during the period                  | \$ 2,964   |
| Average interest rate during the period                | 2.63 %   |
| Average interest rate at the end of the period         | 2.43 %   |

As of September 30, 2019 and December 31, 2018, we had three unsecured federal funds lines of credit with up to \$10.0 million, \$19.0 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 September 30, 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<br>Percentage for the<br>Three Month<br>Period Ended<br>September 30, 2019 | Average<br>Percentage for the<br>Nine Month<br>Period Ended<br>September 30, 2019 |
|---|--|---|
| <b>Sources of Funds:</b>                                  |  |   |
| Deposits:   |  |   |
| Noninterest-bearing                                       | 17.92 %  | 19.40 %   |
| Interest-bearing  | 68.67  | 66.80   |
| FHLB  | 0.88   | 1.12  |
| Convertible subordinated debentures                       | —  | —   |
| Subordinated notes  | 0.55   | 0.56  |
| Credit note   | —  | —   |
| Other liabilities   | 1.65   | 1.67  |
| Shareholders' equity                                      | 10.33  | 10.45   |
| Total   | 100.00 %   | 100.00 %  |
| <b>Uses of Funds:</b>                                     |  |   |
| Total loans   | 77.24 %  | 79.18 %   |
| Available-for-sale securities                             | 4.27   | 4.44  |
| Mortgage loans held for sale                              | 4.37   | 2.80  |
| Promissory notes from related parties                     | —  | —   |
| Interest-bearing deposits in other financial institutions | 7.38   | 6.18  |
| Noninterest-earning assets                                | 6.74   | 7.40  |
| Total   | 100.00 %   | 100.00 %  |
| Average noninterest-bearing deposits to average deposits  | 20.70 %  | 22.50 %   |
| Average loans to average deposits                         | 89.93  | 92.62   |
| Total interest-bearing deposits to total deposits         | 79.30 %  | 77.50 %   |

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 \$8.9 million, or 7.6%, from December 31, 2018 to \$125.7 million at September 30, 2019. The increase is primarily due to net income of \$5.4 million and a \$1.8 million increase in the unrealized gain on our available-for-sale investments primarily due to changes in market rates.

On June 14, 2019, the Company announced that its Board of Directors had authorized a share repurchase program under which the Company may repurchase up to 300,000 shares of its common stock. The Board of Governors of the Federal Reserve System advised the Company that it had no objection to the Company's stock repurchase program. The repurchase program authorizes the Company to purchase its common stock from time to time in the open market (including pursuant to a "Rule 10b5-1 plan"), in block transactions, in privately negotiated transactions, through accelerated stock repurchase programs, through option or other forward transactions or otherwise, all in compliance with applicable laws and other restrictions. The program will be in effect for a one-year period, with the timing of purchases and the number of shares repurchased under the program dependent upon a variety of factors including price, trading volume, corporate and regulatory requirements and market conditions. The repurchase program may be suspended or discontinued at any time without notice.

During the three months ended September 30, 2019, the Company repurchased 582 shares at an average price of \$14.00 and as of September 30, 2019, 299,418 shares may yet be purchased under the program.

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 September 30, 2019 and December 31, 2018, our holding company and Bank exceeded the minimum capital levels required by their respective regulators. At September 30, 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.

| <i>(Dollars in thousands)</i>                      | September 30, 2019 |         | December 31, 2018 |         |
|--|--------------------|---------|-------------------|---------|
|  | Amount             | Ratio   | Amount            | Ratio   |
| Common Equity Tier 1(CET1) to risk-weighted assets |                    |         |                   |         |
| Bank   | \$ 96,495          | 10.98 % | \$ 87,291         | 10.55 % |
| Consolidated Company                               | 103,458            | 11.73   | 94,335            | 11.35   |
| Tier 1 capital to risk-weighted assets             |                    |         |                   |         |
| Bank   | 96,495             | 10.98   | 87,291            | 10.55   |
| Consolidated Company                               | 103,458            | 11.73   | 94,335            | 11.35   |
| Total capital to risk-weighted assets              |                    |         |                   |         |
| Bank   | 104,323            | 11.87   | 94,906            | 11.47   |
| Consolidated Company                               | 117,846            | 13.36   | 108,510           | 13.06   |
| Tier 1 capital to average assets                   |                    |         |                   |         |
| Bank   | 96,495             | 8.19    | 87,291            | 8.63    |
| Consolidated Company                               | \$ 103,458         | 8.76 %  | \$ 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 September 30, 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        | \$ 10,000                | \$ —                                   | \$ —                                    | \$ —                 | \$ 10,000 |
| Subordinated notes | —                        | —                                      | —                                       | 6,560 <sup>(1)</sup> | 6,560     |
| Total              | \$ 10,000                | \$ —                                   | \$ —                                    | \$ 6,560             | \$ 16,560 |

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

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

|                                   | September 30, 2019 |               | December 31, 2018 |               |
|-----------------------------------|--------------------|---------------|-------------------|---------------|
|                                   | Fixed Rate         | Variable Rate | Fixed Rate        | Variable Rate |
| Unused lines of credit            | \$ 35,724          | \$ 245,642    | \$ 33,571         | \$ 271,580    |
| Standby letters of credit         | 65                 | 23,499        | 40                | 23,508        |
| Commitments to make loans to sell | 81,158             | —             | 17,207            | —             |
| Commitments to make loans         | —                  | 10,000        | —                 | —             |

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 Condensed Consolidated Financial Statements as well as the Company's Annual Report on Form 10-K for the year ended December 31, 2018 as filed with the SEC.

### **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 September 30, 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 |
| 200                                     | (0.02)%                               | (0.02)%                                | (3.48)%                               | (8.18)%                                |
| 100                                     | 0.45                                  | 2.00                                   | (1.12)                                | (2.69)                                 |
| Base                                    | —                                     | —                                      | —                                     | —                                      |
| -100                                    | (0.87)                                | (12.57)                                | 2.74                                  | (0.02)                                 |
| -200                                    | 3.88                                  | (9.59)                                 | 0.76                                  | (10.68)                                |

The model simulations as of September 30, 2019 imply that our balance sheet is more neutral 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 condensed 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 September 30, 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 8 - Commitments and Contingencies in the Notes to Condensed 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**

##### **(c) Issuer Purchases of Equity Securities**

|  | Total number<br>of shares<br>purchased | Average<br>price paid<br>per share | Total number of<br>shares purchased<br>as part of publically<br>announced plans<br>or programs | Maximum number (or<br>approximate dollar<br>value) of shares<br>that may yet be<br>purchased under the<br>plans or programs |
|--|--|------------------------------------|--|---|
| July 1, 2019 through July 31, 2019           | —                                      | \$ —                               | —  | 300,000   |
| August 1, 2019 through August 31, 2019       | —                                      | —                                  | —  | 300,000   |
| September 1, 2019 through September 30, 2019 | 582                                    | 14.00                              | —  | 299,418   |

On June 14, 2019, the Company announced that its Board of Directors had authorized a share repurchase program under which the Company may repurchase up to 300,000 shares of its common stock and that the Board of Governors of the Federal Reserve System advised the Company that it had no objection to the Company's stock repurchase program. The repurchase program authorizes the Company to purchase its common stock from time to time in privately negotiated transactions, in the open market, including pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 plan promulgated by the Securities and Exchange Commissions, or otherwise in a manner that complies with applicable

federal securities laws. The program will be in effect for a one-year period, with the timing of purchases and the number of shares repurchased under the program dependent upon a variety of factors including price, trading volume, corporate and regulatory requirements and market conditions. The repurchase program may be suspended or discontinued at any time without notice. For the three months ended September 30, 2019, the Company repurchased 582 shares at an average price of \$14.00 and as of September 30, 2019, 299,418 shares may yet be purchased under the program.

**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   |
|-------------|---|
| 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.**

November 7, 2019  
\_\_\_\_\_  
Date

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

November 7, 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: November 7, 2019

/s/ Scott C. Wylie

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: November 7, 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 September 30, 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: November 7, 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 September 30, 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: November 7, 2019

/s/ Julie A. Courkamp

Julie A. Courkamp

Chief Financial Officer and Treasurer

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