

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2019

or

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

For the transition period from _____ to _____

Commission File Number: 001-36522



Investar Holding Corporation

(Exact name of registrant as specified in its charter)

Louisiana
(State or other jurisdiction of
incorporation or organization)

27-1560715
(I.R.S. Employer
Identification No.)

10500 Coursey Blvd., Baton Rouge, Louisiana 70816
(Address of principal executive offices, including zip code)
(225) 227-2222

(Registrant's telephone number, including area code)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common stock, \$1.00 par value per share	ISTR	The Nasdaq Global Market

Securities registered pursuant to Section 12(g) of the Act: None

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

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

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

Indicate by check mark whether the registrant has submitted electronically 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	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

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

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

The aggregate market value of the voting stock held by non-affiliates of the registrant, computed by reference to the closing price of the common stock as of June 28, 2019, was approximately \$219.1 million.

The number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date, is as follows: Common stock, \$1.00 par value per share, 10,941,552 shares outstanding as of March 11, 2020.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Definitive Proxy Statement relating to the 2020 Annual Meeting of Shareholders of Investar Holding Corporation are incorporated by reference into Part III of the Form 10-K. Such Definitive Proxy Statement will be filed with the Securities and Exchange Commission within 120 days after the end of the registrant's fiscal year ended December 31, 2019.

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PART I

Item 1. Business

General

Investar Holding Corporation (the “Company”), a Louisiana corporation incorporated in 2009, is a financial holding company headquartered in Baton Rouge, Louisiana that conducts its operations primarily through its wholly-owned subsidiary, Investar Bank, National Association (the “Bank”), a national bank chartered by the Office of the Comptroller of Currency (“OCC”). The Bank was originally chartered as a Louisiana commercial bank in 2006 and converted to a national bank in July 2019. Through the Bank, the Company offers a wide range of commercial banking products tailored to meet the needs of individuals and small to medium-sized businesses. Our primary areas of operation are south Louisiana (approximately 86% of our total deposits as of December 31, 2019), including Baton Rouge, New Orleans, Lafayette, and their surrounding areas; as of March 1, 2019, southeast Texas, including Houston and its surrounding area; and as of November 1, 2019, west Alabama, including York and its surrounding area. These markets are served from our executive and operations center located in Baton Rouge and from 30 full service branches located throughout our market areas. We have experienced significant growth since the Bank was chartered, completing six whole-bank acquisitions, as described below in more detail, and establishing additional branches in our market areas. On December 20, 2019, we announced a definitive agreement to acquire Cheaha Financial Group, Inc., with four branches in Calhoun County in northeast Alabama.

As of December 31, 2019, on a consolidated basis, the Company had total assets of \$2.1 billion, net loans of \$1.7 billion, total deposits of \$1.7 billion, and stockholders’ equity of \$242.0 million.

Management believes that the current markets present a significant opportunity for growth and franchise expansion, both organically and through strategic acquisitions. Although the financial services industry is rapidly changing and intensely competitive, and likely to remain so, we believe that the Bank competes effectively as a local community bank and possesses the consistency of local leadership, the availability of local access and responsive customer service, coupled with competitively-priced products and services, necessary to successfully compete with other financial institutions for individual and small to medium-sized business customers.

The information set forth in this Annual Report on Form 10-K is as of March 13, 2020, unless otherwise indicated herein.

Operations

General. We offer a full range of commercial and retail lending products throughout our market areas, including business loans to small to medium-sized businesses as well as loans to individuals. Our business lending products include owner-occupied commercial real estate loans, construction loans and commercial and industrial loans, such as term loans, equipment financing and lines of credit, while our loans to individuals include first and second mortgage loans, installment loans, and lines of credit. For business customers, we target small to medium-sized businesses and professional organizations such as law firms, accounting firms and medical practices.

Management considers all of our operations to be aggregated in one reportable operating segment, and accordingly, no separate segment disclosures are presented in this report.

Lending Activities. Income generated by our lending activities represents a substantial portion of our total revenue. For the years ended December 31, 2019, 2018 and 2017, income from our lending activities comprised 85%, 85% and 84%, respectively, of our total revenue. Over the last three fiscal years, we have increased our focus on commercial real estate loans and commercial and industrial loans, including adding and expanding a new Commercial and Industrial division in early 2018.

Lending to Businesses. Our lending to small to medium-sized businesses falls into three general categories:

- *Commercial real estate loans.* Approximately 48% of our total loans at December 31, 2019 were commercial real estate loans, which include multifamily, farmland and commercial real estate loans, with owner-occupied loans comprising approximately 43% of the commercial real estate loan portfolio. Commercial real estate loan terms generally are 10 years or less, although payments may be structured on a longer amortization basis. Interest rates may be fixed or adjustable, although rates typically will not be fixed for a period exceeding 120 months, and we generally charge an origination fee. We do not offer non-recourse loans. Risks associated with commercial real estate loans include, among other things, fluctuations in the value of real estate, new job creation trends, tenant vacancy rates, and the quality of the borrower's management. We attempt to limit risk by analyzing a borrower's cash flow and collateral value on an ongoing basis. Also, we typically require personal guarantees from the principal owners of the property, supported by a review of their personal financial statements, as an additional means of mitigating our risk. We also manage risk by avoiding concentrations in any one business or industry.
- *Commercial and industrial loans.* Commercial and industrial loans primarily consist of working capital lines of credit and equipment loans. We often make commercial loans to borrowers with whom we have previously made a commercial real estate loan. The terms of these loans vary by purpose and by type of underlying collateral. We make equipment loans for a term of five years or less at fixed or variable rates, with the loan fully amortized over the term and secured by the relevant piece of equipment. Loans to support working capital typically have terms not exceeding one year, and such loans are secured by accounts receivable or inventory. Fixed rate loans are priced based on collateral, term and amortization. The interest rate for floating rate loans is typically tied to the prime rate published in The Wall Street Journal. Commercial and industrial loans accounted for approximately 19% of our total loans at December 31, 2019.

Commercial lending generally involves different risks from those associated with commercial real estate lending or construction lending. Although commercial loans may be collateralized by equipment or other business assets (including real estate, if available as collateral), the repayment of these types of loans depends primarily on the creditworthiness and projected cash flow of the borrower (and any guarantors). Thus, the general business conditions of the local economy and the borrower's ability to sell its products and services, thereby generating sufficient operating revenue to repay us under the agreed upon terms and conditions, are the chief considerations when assessing the risk of a commercial loan. The liquidation of collateral, if any, is considered a secondary source of repayment because equipment and other business assets may, among other things, be obsolete or of limited resale value. We actively monitor certain financial measures of the borrower, including advance rate, cash flow, collateral value and other appropriate credit factors.

- *Construction and development loans.* Construction and development loans, which consist of loans for the construction of commercial projects, single family residential properties and multifamily properties, accounted for approximately 12% of our total loans at December 31, 2019. Our construction and development loans are made on both a "pre-sold" basis and on a "speculative" basis. Construction and development loans are generally made with a term of 6 to 18 months, with interest accruing at either a fixed or floating rate and paid monthly. These loans are secured by the underlying project being built. For construction loans, loan to value ratios range from 70% to 80% of the developed/completed value, while for development loans our loan to value ratios typically will not exceed 70% to 75% of such value. Speculative loans are based on the borrower's financial strength and cash flow position, and we disburse funds in installments based on the percentage of completion and only after the project has been inspected by an experienced construction lender or third-party inspector.

Construction lending entails significant additional risks compared to commercial real estate or residential real estate lending due to the dynamics of construction projects, changes in interest rates, the long-term financing market, and state and local government regulations. One such risk is that loan funds are advanced upon the security of the property under construction, which is of uncertain value prior to the completion of construction. Thus, it is more difficult to accurately evaluate the total loan funds required to complete a project and to calculate related loan-to-value ratios. We attempt to minimize the risks associated with construction lending by limiting loan-to-value ratios as described above. In addition, as to speculative development loans, we generally make such loans only to borrowers that have a positive pre-existing relationship with us. We also manage risk by using specific underwriting policies and procedures for these types of loans and by avoiding excessive concentrations in any one business or industry.

Lending to Individuals. We make the following types of loans to our individual customers:

- *Residential real estate.* One-to-four family residential real estate loans, including second mortgage loans, comprised approximately 19% of our total loans at December 31, 2019. Second mortgage loans in this category include only loans we make to cover the gap between the purchase price of a residence and the amount of the first mortgage; all other second mortgage loans are considered consumer loans. Loan to value ratios do not typically exceed 80%, although some of the mortgage loans that we retain in our portfolio may have higher loan to value ratios. We use an independent appraiser to establish collateral values. We generate residential real estate mortgage loans through Bank referrals and contacts with real estate agents in our markets. We do not originate subprime residential real estate loans.
- *Consumer loans.* Consumer loans represented 2% of our total loans at December 31, 2019. We make these loans (which are normally fixed-rate loans) to individuals for a variety of personal, family and household purposes, secured and unsecured installment and term loans, second mortgages, home equity loans and home equity lines of credit. Because many consumer loans are secured by depreciable assets such as cars, boats and trailers, the loans are amortized over the useful life of the asset. The amortization of second mortgages generally does not exceed 15 years and the rates generally are not fixed for more than 60 months. As a general matter, in underwriting these loans, our credit analysts review a borrower's past credit history, credit scores, past income level, debt history and, when applicable, cash flow, debt to income ratio, and payment to income, and determine the impact of all these factors on the ability of the borrower to make future payments as agreed. A comparison of the value of the collateral, if any, to the proposed loan amount, is also a consideration in the underwriting process. Repayment of consumer loans depends upon key consumer economic measures and upon the borrower's financial stability and is more likely to be adversely affected by divorce, job loss, illness and personal hardships than repayment of other loans. A shortfall in the value of any collateral also may pose a risk of loss to us for these types of loans.

Indirect auto loans historically comprised the largest component of our consumer loans, however, only 44% of our total consumer loans were indirect auto loans at December 31, 2019. We were an indirect lender for our auto loans, meaning that the loans were originated by automobile dealerships and then assigned to us. These dealerships were selected based on our review of their operating history and the dealership's reputation in the marketplace, which we believe helped to mitigate the risks of fraud or negligence by the dealership. At all times, the decision whether or not to provide financing resided with us.

In November 2015, the Bank announced that it was exiting the indirect auto loan origination business. The Bank discontinued accepting indirect auto loan applications December 31, 2015, but continued to process and fund applications that were accepted on or before that date. The Bank will continue to service the current indirect auto loan portfolio for its duration. At December 31, 2019, the weighted average remaining term of the indirect auto loan portfolio was 2 years.

Deposits. We offer a broad base of deposit products and services to our individual and business clients, including savings, checking, and money market accounts, debit cards and mobile banking with smartphone deposit capability, as well as a variety of certificates of deposit and individual retirement accounts. We also offer a reciprocal deposit product that allows customers to deposit funds in excess of the \$250,000 FDIC insurance limit and have the funds insured by the FDIC. For our business clients, we offer a competitive suite of cash management products which include, but are not limited to, remote deposit capture, virtual vault, electronic statements, positive pay, ACH origination and wire transfer, investment sweep accounts and enhanced business internet banking.

Other Banking Services. The Bank's other banking services include cashiers' checks, direct deposit of payroll and Social Security checks, night depository, bank-by-mail, automated teller machines with deposit automation, interactive teller machines, video banking, debit cards and mobile wallet payment options. We have also associated with nationwide networks of automated teller machines, enabling the Bank's customers to use ATMs throughout our markets and other regions. We offer merchant card services through a third-party vendor and a business credit card product. The Bank does not offer trust services or insurance products.

Acquisition Activity

General. To complement our organic growth strategy, from time to time, we evaluate potential acquisition opportunities including whole-bank acquisitions and strategic branch acquisitions. We believe there are many banking institutions that continue to face credit challenges, capital constraints and liquidity issues and that lack the scale and management expertise to manage the increasing regulatory burden. Our management team has a long history of identifying targets, assessing and pricing risk and executing acquisitions in a creative, yet disciplined, manner. We seek acquisitions that provide meaningful financial benefits, long-term organic growth opportunities and expense reductions, without compromising our risk profile. Additionally, we seek banking markets with favorable competitive dynamics and potential consolidation opportunities. All of our acquisition activity is evaluated and overseen by a standing Merger and Acquisition Committee of our board of directors. Acquisitions completed since January 1, 2017 and any pending acquisitions are discussed below.

Acquisition of Citizens Bancshares, Inc. On July 1, 2017, the Company completed its acquisition of Citizens Bancshares, Inc. (“Citizens”) and its wholly-owned subsidiary, Citizens Bank, headquartered in Ville Platte, Louisiana, with two additional branch locations in Mamou and Pine Prairie, Louisiana. The Company acquired all of the outstanding common stock of the former Citizens shareholders for a total cash consideration of \$45.8 million. The Company acquired assets with a fair value of approximately \$250.7 million, including \$129.2 million in loans, assumed \$212.2 million in deposits, and recognized \$9.1 million in goodwill.

Acquisition of BOJ Bancshares, Inc. On December 1, 2017, the Company completed its acquisition of BOJ Bancshares, Inc. (“BOJ”) and its wholly-owned subsidiary, The Highlands Bank, headquartered in Jackson, Louisiana, with four additional branch locations in Baton Rouge, Slaughter, St. Francisville, and Zachary, Louisiana. The Company acquired all of the outstanding common stock of the former BOJ shareholders for a total consideration of \$22.7 million, \$3.95 million of which was cash with the remaining consideration in the form of 799,559 shares of the Company’s common stock. The Company acquired assets with a fair value of approximately \$152.1 million, including \$102.4 million in loans, assumed \$125.8 million in deposits, and recognized \$5.7 million in goodwill.

Acquisition of Mainland Bank. On March 1, 2019, the Company completed its acquisition of Mainland Bank (“Mainland”), headquartered in Texas City, Texas, with two additional branch locations in Houston and Dickinson, Texas. The Company acquired all of the outstanding common stock of the former Mainland shareholders for a total consideration of \$18.6 million in the form of 763,849 shares of the Company’s common stock. The Company acquired assets with a fair value of approximately \$128.4 million, including \$82.4 million in loans, assumed \$107.6 million in deposits, and recognized \$4.5 million in goodwill.

Acquisition of Bank of York. On November 1, 2019, the Company completed its acquisition of Bank of York, headquartered in York, Alabama, with an additional branch location in Livingston, Alabama. The Company acquired all of the outstanding common stock of the former Bank of York shareholders for a total cash consideration of \$15.0 million. Bank of York was also permitted under the terms of the merger agreement to make a special pre-closing cash distribution to its shareholders in an aggregate amount of approximately \$1.0 million. The Company acquired assets with a fair value of approximately \$102.0 million, including \$46.1 million in loans, assumed \$85.0 million in deposits, and recognized \$4.2 million in goodwill.

Acquisition of two branches from PlainsCapital Bank. On February 21, 2020, the Bank completed its previously announced acquisition and assumption of certain assets, deposits and other liabilities associated with the Alice and Victoria, Texas locations of PlainsCapital Bank, a wholly-owned subsidiary of Hilltop Holdings Inc. The Bank acquired approximately \$45.9 million in loans and \$37.3 million in deposits. In addition, the Bank acquired substantially all the fixed assets at the branch locations, and assumed the leases for the branch facilities.

Definitive Agreement with Cheaha Financial Group, Inc. On December 20, 2019 the Company announced that it has entered into a definitive agreement (the “Agreement”) to acquire Cheaha Financial Group, Inc. (“Cheaha”), headquartered in Oxford, Alabama, and its wholly-owned subsidiary, Cheaha Bank. According to the terms of the Agreement, the Company will pay \$80.00 in cash consideration for each share of Cheaha common stock, for an aggregate value of approximately \$41.1 million. At December 31, 2019, Cheaha Bank had approximately \$209.6 million in assets, \$119.6 million in net loans, \$179.0 million in deposits, and \$28.1 million in stockholders’ equity. Cheaha Bank offers a full range of banking products and services to individuals and small businesses from four branch locations in Calhoun County, Alabama.

De Novo Branches

During our last three fiscal years, we have opened five full-service branch locations in Louisiana, consisting of two locations in the Baton Rouge market, one location in the New Orleans market, one location in the Lake Charles market, and one location in the Lafayette market, in addition to the branches we acquired through our acquisition activity described above. We expect to open two de novo branches in 2020.

Competition

We face competition in all major product and geographic areas in which we conduct our operations. Through the Bank, we compete for available loans and deposits with state, regional and national banks, as well as savings and loan associations, credit unions, finance companies, mortgage companies, insurance companies, brokerage firms and investment companies. All of these institutions compete in the delivery of services and products through availability, quality and pricing, both with respect to interest rates on loans and deposits and fees charged for banking services. Many of our competitors are larger and have substantially greater resources than we do, including higher total assets and capitalization, greater access to capital markets, and a broader offering of financial services. As larger institutions, many of our competitors can offer more attractive pricing than we can offer and have more extensive branch networks from which they can offer their financial services products.

While we continually strive to offer competitive pricing for our banking products, we believe that our community bank approach to customers, focusing on quality customer service, and maintaining strong customer relationships affords us the best opportunity to successfully compete with other institutions. In addition, as a smaller institution, we think we can be flexible in developing and implementing new products and services. Further, in recent years there has been consolidation activity involving banks with a presence in our markets. In our view, mergers and other business combinations within our markets provide us with growth opportunities. Many acquisitions, especially when local institutions are acquired by institutions based outside our markets, result not only in customer disruption but also in a loss of market knowledge and relationships that we believe provide us the opportunity to acquire customers seeking a personalized approach to banking. Furthermore, acquisition activity typically creates opportunities to hire talented personnel from the combining institutions.

The following table sets forth certain information about our total deposits, and our share of total deposits, in specified locations, and is shown as of June 30, 2019, which is the latest date for which such information is available.

Location	Investar Total Deposits (in millions)	Investar Share of Deposits
Baton Rouge, Louisiana	\$ 749	4.0%
New Orleans, Louisiana	198	1.0
Lafayette, Louisiana	171	2.5
Evangeline Parish, Louisiana ⁽¹⁾	190	30.2
East and West Feliciana Parishes, Louisiana ⁽¹⁾	132	27.6
Houston, Texas	113	0.1
Sumter County, Alabama ⁽¹⁾	82	41.8

⁽¹⁾ Evangeline Parish, East and West Feliciana Parishes, and Sumter County are not included in Metropolitan Statistical Areas but are included in this table to reflect the deposit balances of our acquired branches in these parishes and county. The branches in Sumter County were not acquired from Bank of York until November 1, 2019, but are shown on a pro forma basis.

Supervision and Regulation

General. Banking is highly regulated under federal and state law. The following is a brief summary of certain aspects of that regulation which are material to us, and does not purport to be a complete description of all regulations that affect us or all aspects of those regulations. To the extent particular statutory and regulatory provisions are described, the description is qualified in its entirety by reference to the particular statute or regulation.

We are a financial holding company registered under the Bank Holding Company Act of 1956, as amended, and are subject to supervision, regulation and examination by the Federal Reserve. The Bank is a national bank chartered under the laws of the United States by the OCC and is subject to supervision, regulation and examination by the OCC. This system of supervision and regulation establishes a comprehensive framework for our operations and, consequently, can have a material impact on our growth and earnings performance.

The primary goals of the bank regulatory scheme are to maintain a safe and sound banking system and to facilitate the conduct of sound monetary policy. This system is intended primarily for the protection of the Federal Deposit Insurance Corporation's ("FDIC") deposit insurance funds, bank depositors, and the public, rather than our shareholders and creditors. The banking agencies have broad enforcement power over bank holding companies and banks, including the authority, among other things, to enjoin "unsafe or unsound" practices, require affirmative action to correct any violation or practice, issue administrative orders that can be judicially enforced, direct increases in capital, direct the sale of subsidiaries or other assets, limit dividends and distributions, restrict growth, assess civil monetary penalties, remove officers and directors, and, with respect to banks, terminate deposit insurance or place the bank into conservatorship or receivership. In general, these enforcement actions may be initiated for violations of laws and regulations or unsafe or unsound practices.

The Dodd-Frank Act. The Dodd-Frank Act, enacted on July 21, 2010, aims to restore responsibility and accountability to the financial system by significantly altering the regulation of financial institutions and the financial services industry. Full implementation of the Dodd-Frank Act has required many new rules to be issued by federal regulatory agencies over the last several years, and will continue to profoundly affect how financial institutions will be regulated in the future.

The Dodd-Frank Act, among other things:

- established the Consumer Financial Protection Bureau, an independent organization within the Federal Reserve with centralized responsibility for promulgating and enforcing federal consumer protection laws applicable to all entities offering consumer financial products or services;
- established the Financial Stability Oversight Council, tasked with the authority to identify and monitor institutions and systems that pose a systemic risk to the financial system;
- changed the assessment base for federal deposit insurance from the amount of insured deposits held by the depository institution to the institution's average total consolidated assets less tangible equity;
- increased the minimum reserve ratio for the Deposit Insurance Fund from 1.15% to 1.35%;
- permanently increased the deposit insurance coverage amount from \$100,000 to \$250,000;
- required the federal banking agencies to make their capital requirements for insured depository institutions countercyclical, so that capital requirements increase in times of economic expansion and decrease in times of economic contraction;
- directed the Federal Reserve to establish interchange fees for debit cards under a restrictive "reasonable and proportional cost" per transaction standard;
- limited the ability of banking organizations to sponsor or invest in private equity and hedge funds and to engage in proprietary trading;
- increased regulation of consumer protections regarding mortgage originations, including originator compensation, minimum repayment standards, prepayment consideration, and mortgage servicing;
- restricted the preemption of select state laws by federal banking law applicable to national banks and disallowed subsidiaries and affiliates of national banks from availing themselves of such preemption;
- authorized national and state banks to establish de novo branches in any state that would permit a bank chartered in that state to open a branch at that location; and
- repealed the federal prohibition on the payment of interest on commercial demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.

Some of these provisions have had and may continue to have the consequence of increasing our expenses, decreasing our revenues, and changing the activities in which we choose to engage. The environment in which banking organizations have operated after the financial crisis, including legislative and regulatory changes affecting capital, liquidity, supervision, permissible activities, corporate governance and compensation, changes in fiscal policy and steps to eliminate government support for banking organizations, may have long-term effects on the business model and profitability of banking organizations that cannot currently be foreseen. The specific impact on our current activities or new financial activities we may consider in the future, our financial performance and the markets in which we operate will depend on the manner in which the relevant agencies develop and implement the required rules and the reaction of market participants to these regulatory developments. Many aspects of the Dodd-Frank Act are subject to ongoing implementation. While we cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have on us, these changes could be materially adverse to our financial condition and results of operations.

The Volcker Rule. On December 10, 2013, the Federal Reserve and the other federal banking regulators as well as the SEC each adopted a final rule implementing Section 619 of the Dodd-Frank Act, commonly referred to as the "Volcker Rule." Generally speaking, the final rule prohibits a bank and its affiliates from engaging in proprietary trading and from sponsoring certain "covered funds" or from acquiring or retaining any ownership interest in such covered funds. Most private equity, venture capital and hedge funds are considered "covered funds" as are bank trust preferred collateralized debt obligations. The final rule requires banking entities to divest disallowed securities by July 21, 2015, subject to extension upon application. The Volcker Rule does not impact any of our current activities nor do we hold any securities that we would be required to sell under the Rule, but it does limit the scope of permissible activities in which we might engage in the future.

Regulatory Capital Requirements

Capital Adequacy. The Federal Reserve Board monitors the capital adequacy of the Company, on a consolidated basis, and the OCC monitors the capital adequacy of the Bank. The regulatory agencies use a combination of risk-based guidelines and a leverage ratio to evaluate capital adequacy and consider these capital levels when taking action on various types of applications and when conducting supervisory activities related to safety and soundness. The risk-based capital standards are designed to make regulatory capital requirements more sensitive to differences in risk profiles among financial institutions and their holding companies, to account for off-balance sheet exposure, and to minimize disincentives for holding liquid assets. A financial institution's assets and off-balance sheet items, such as letters of credit and unfunded loan commitments, are assigned to broad risk categories, each with appropriate risk weights. Regulatory capital, in turn, is classified in one of two tiers. "Tier 1" capital includes two components: (1) common equity Tier 1 capital and (2) additional Tier 1 capital. Common equity Tier 1 capital consists solely of common stock (plus related surplus), retained earnings and limited amounts of minority interests that are in the form of common stock. Additional Tier 1 capital includes other perpetual instruments historically included in Tier 1 capital, such as non-cumulative perpetual preferred stock. "Tier 2" capital includes, among other things, qualifying subordinated debt and allowances for loan and lease losses, subject to limitations. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items.

Under the current regulatory framework, we are required to maintain the following minimum regulatory capital ratios:

- A ratio of common equity Tier 1 capital to total risk-weighted assets of at least 4.5%;
- A ratio of Tier 1 capital to total risk-weighted assets of at least 6.0%;
- A ratio of Tier 1 capital plus Tier 2 capital to total risk-weighted assets of at least 8.0%; and
- A leverage ratio (Tier 1 capital to adjusted total assets) of at least 4.0%.

In addition to these minimum regulatory capital ratios, the regulations establish a capital conservation buffer with respect to the first three capital ratios listed above. Specifically, banking organizations must hold common equity Tier 1 capital in excess of their minimum risk-based capital ratios by at least 2.5% of risk-weighted assets in order to avoid limits on capital distributions (including dividend payments, discretionary payments on Tier 1 instruments, and stock buybacks) and certain discretionary bonus payments to executive officers. Thus, when including the 2.5% capital conservation buffer, a bank holding company and bank's minimum ratio of common equity Tier 1 capital to total risk-weighted assets becomes 7%, its minimum ratio of Tier 1 capital to total risk-weighted assets becomes 8.5%, and its minimum ratio of total capital to total risk-weighted assets becomes 10.5%.

We were in compliance with all applicable minimum regulatory capital requirements as of December 31, 2019.

The required capital ratios set forth above are minimums, and the Federal Reserve and the OCC may determine that a banking organization, based on its size, complexity or risk profile, must maintain a higher level of capital in order to operate in a safe and sound manner. Risks such as concentration of credit risks and the risk arising from non-traditional activities, as well as the institution's exposure to a decline in the economic value of its capital due to changes in interest rates, and an institution's ability to manage those risks are important factors that are to be taken into account by the federal banking agencies in assessing an institution's overall capital adequacy.

The federal banking agencies finalized a rule in November 2019 that allows bank holding companies and banks with less than \$10.0 billion in total consolidated assets and limited amounts of certain assets and off balance sheet exposures and a bank leverage ratio of greater than 9% to elect to use the Community Bank Leverage Ratio ("CBLR") framework. A community banking organization electing to use the CBLR framework would have a simplified capital regime and would be considered well capitalized as long as it had a leverage ratio of greater than 9%. It is uncertain if we will elect to use the CBLR framework.

Furthermore, in December 2018, the U.S. federal banking agencies finalized rules that would permit bank holding companies and banks to phase-in, for regulatory capital purposes, the day-one impact of the new current expected credit loss accounting rule in retained earnings over a period of three years commencing with time of adoption of the new standard. For further discussion of the new current expected credit loss accounting rule, see Note 1 to the consolidated financial statements and also see *"Our allowance for loan losses may prove to be insufficient to absorb losses inherent in our loan portfolio, and we may be required to further increase our provision for loan losses"* in Item 1A, Risk Factors.

Prompt Corrective Action Regulations. Under the prompt corrective action regulations, the OCC is required and authorized to take supervisory actions against undercapitalized financial institutions. For this purpose, a bank is placed in one of the following five categories based on its capital: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Under the prompt corrective action regulations, as currently in effect, to be well capitalized, a bank must have a leverage capital ratio of at least 5%, a common equity Tier 1 capital ratio of at least 6.5%, a Tier 1 risk-based capital ratio of at least 8%, and a total risk-based capital ratio of at least 10%, and must not be subject to any order or written agreement or directive by a federal banking agency to meet and maintain a specific capital level for any capital measure.

Federal banking regulators are required to take various mandatory supervisory actions and are authorized to take other discretionary actions with respect to institutions in the three undercapitalized categories that, if undertaken, could have a material adverse effect on the institution's operations or financial condition. For example, only a well-capitalized depository institution may accept brokered deposits without prior regulatory approval. The severity of the action depends upon the capital category in which the institution is placed. Generally, subject to a narrow exception, banking regulators must appoint a receiver or conservator for an institution that is critically undercapitalized. The federal banking agencies have specified by regulation the relevant capital level for each category. An institution that is categorized as undercapitalized, significantly undercapitalized, or critically undercapitalized is required to submit an acceptable capital restoration plan to its appropriate federal banking agency. An undercapitalized institution also is generally prohibited from increasing its average total assets, making acquisitions, establishing any branches or engaging in any new line of business, except under an accepted capital restoration plan or with OCC approval. The regulations also establish procedures for downgrading an institution to a lower capital category based on supervisory factors other than capital.

Furthermore, a bank holding company must guarantee that a subsidiary depository institution meets its capital restoration plan, subject to various limitations. The controlling holding company's obligation to fund a capital restoration plan is limited to the lesser of 5% of an undercapitalized subsidiary's assets at the time it became undercapitalized or the amount required to meet regulatory capital requirements.

The capital classification of a bank affects the frequency of regulatory examinations, the bank's ability to engage in certain activities, and the deposit insurance premiums paid by the bank. As of December 31, 2019, the Bank met the requirements to be categorized as well capitalized under the prompt corrective action framework as currently in effect.

Acquisitions by Bank Holding Companies

Federal laws, including the Bank Holding Company Act and the Change in Bank Control Act, impose additional prior notice or approval requirements and ongoing regulatory requirements on any investor that seeks to acquire direct or indirect "control" of an FDIC-insured depository institution or bank holding company. We must obtain the prior approval of the Federal Reserve before (1) acquiring more than 5% of the voting stock of any bank or other bank holding company, (2) acquiring all or substantially all of the assets of any bank or bank holding company, or (3) merging or consolidating with any other bank holding company. The Federal Reserve may determine not to approve any of these transactions if it would result in or tend to create a monopoly or substantially lessen competition or otherwise function as a restraint of trade, unless the anti-competitive effects of the proposed transaction are clearly outweighed by the public interest in meeting the convenience and needs of the community to be served. The Federal Reserve is also required to consider the financial and managerial resources and future prospects of the bank holding companies and banks concerned, the convenience and needs of the community to be served, and the record of a bank holding company and its subsidiary bank(s) in combating money laundering activities. In addition, a failure to implement and maintain adequate compliance programs could cause the Federal Reserve or other banking regulators not to approve an acquisition when regulatory approval is required or to prohibit an acquisition even if approval is not required.

Scope of Permissible Bank Holding Company Activities

In general, the Bank Holding Company Act limits the activities permissible for bank holding companies to the business of banking, managing or controlling banks, and such other activities as the Federal Reserve has determined to be so closely related to banking as to be properly incident thereto.

A bank holding company may elect to be treated as a financial holding company and receive expanded powers if it and its depository institution subsidiaries are “well capitalized” and “well managed,” and its subsidiary banks controlled by it have at least a “satisfactory” Community Reinvestment Act rating. We have elected for the Company to be treated as a financial holding company. As a financial holding company, we may engage in a range of activities that are (1) financial in nature or incidental to such financial activity or (2) complementary to a financial activity and which do not pose a substantial risk to the safety and soundness of a depository institution or to the financial system generally. These activities include securities dealing, underwriting and market making, insurance underwriting and agency activities, merchant banking and insurance company portfolio investments. Expanded financial activities of financial holding companies generally will be regulated according to the type of such financial activity: banking activities by banking regulators; securities activities by securities regulators; and insurance activities by insurance regulators.

The Bank Holding Company Act does not place territorial limitations on permissible non-banking activities of bank holding companies. The Federal Reserve has the power to order any bank holding company or its subsidiaries to terminate any activity or to terminate its ownership or control of any subsidiary when the Federal Reserve has reasonable grounds to believe that continuation of such activity or such ownership or control constitutes a serious risk to the financial soundness, safety or stability of any bank subsidiary of the bank holding company.

Source of Strength Doctrine for Bank Holding Companies

Under longstanding Federal Reserve policy which has been codified by the Dodd-Frank Act, we are expected to act as a source of financial strength to, and to commit resources to support, the Bank. This support may be required at times when we may not be inclined to provide it. In addition, any capital loans that we make to the Bank are subordinate in right of payment to deposits and to certain other indebtedness of the Bank. In the event of our bankruptcy, any commitment by us to a federal bank regulatory agency to maintain the capital of the Bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

Dividends

As a bank holding company, we are subject to certain restrictions on dividends under applicable banking laws and regulations. The Federal Reserve has issued a policy statement that provides that a bank holding company should not pay dividends unless: (1) its net income over the last four quarters (net of dividends paid) has been sufficient to fully fund the dividends; (2) the prospective rate of earnings retention appears to be consistent with the capital needs, asset quality and overall financial condition of the bank holding company and its subsidiaries; and (3) the bank holding company will continue to meet minimum required capital adequacy ratios. Accordingly, a bank holding company should not pay cash dividends that exceed its net income or that can only be funded in ways that weaken the bank holding company’s financial health, such as by borrowing. The Dodd-Frank Act imposes, and Basel III effected, additional restrictions on the ability of banking institutions to pay dividends. In addition, in the current financial and economic environment, the Federal Reserve Board has indicated that bank holding companies should carefully review their dividend policy and has discouraged payment ratios that are at maximum allowable levels unless both asset quality and capital are very strong.

The Bank is also subject to certain restrictions on dividends under federal laws, regulations and policies. In general, under OCC regulations, the Bank may pay dividends to us without the approval of the OCC only so long as the amount of the dividend does not exceed the Bank’s net income earned during the current year combined with its retained net income (net of dividends paid) of the immediately preceding two years. The Bank must obtain the approval of the OCC for any amount in excess of this threshold. Further, a national bank may not pay a dividend in excess of its undivided profits. In addition, under federal law, the Bank may not pay any dividend to us if it is undercapitalized or the payment of the dividend would cause it to become undercapitalized. The OCC may further restrict the payment of dividends by requiring the Bank to maintain a higher level of capital than would otherwise be required to be adequately capitalized for regulatory purposes. Moreover, if, in the opinion of the OCC, the Bank is engaged in an unsound practice (which could include the payment of dividends even within the legal requirements noted above), the OCC may require, generally after notice and hearing, the Bank to cease such practice. The OCC has indicated that paying dividends that deplete a depository institution’s capital base to an inadequate level would be an unsafe banking practice.

Restrictions on Transactions with Affiliates and Loans to Insiders

Federal law strictly limits the ability of banks to engage in transactions with their affiliates, including their bank holding companies. Sections 23A and 23B of the Federal Reserve Act, and Federal Reserve Regulation W, impose quantitative limits, qualitative standards, and collateral requirements on certain transactions by a bank with, or for the benefit of, its affiliates, and generally require those transactions to be on terms at least as favorable to the bank as transactions with non-affiliates and to be consistent with safe and sound practices. The Dodd-Frank Act significantly expanded the coverage and scope of the limitations on affiliate transactions within a banking organization, including an expansion of the types of transactions that are covered transactions to include credit exposures related to derivatives, repurchase agreements and securities lending arrangements and an increase in the amount of time for which collateral requirements regarding covered transactions must be satisfied.

Federal law also limits a bank's authority to extend credit to its directors, executive officers and 10% shareholders, as well as to entities controlled by such persons. Among other things, extensions of credit to insiders are required to be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons. Also, the terms of such extensions of credit may not involve more than the normal risk of repayment or present other unfavorable features and may not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of the bank's capital.

Incentive Compensation Guidance

The federal banking agencies have issued comprehensive guidance on incentive compensation policies. This guidance is designed to ensure that a financial institution's incentive compensation structure does not encourage imprudent risk taking, which may undermine the safety and soundness of the institution. The guidance, which applies to all employees that have the ability to materially affect an institution's risk profile, either individually or as part of a group, is based upon three primary principles: (1) balanced risk taking incentives; (2) compatibility with effective controls and risk management; and (3) strong corporate governance.

An institution's supervisory ratings will incorporate any identified deficiencies in an institution's compensation practices, and it may be subject to an enforcement action if the incentive compensation arrangements pose a risk to the safety and soundness of the institution. Further, regulations may limit discretionary bonus payments to bank executives if the institution's regulatory capital ratios fail to exceed certain thresholds.

Deposit Insurance Assessments

FDIC insured banks are required to pay deposit insurance assessments to the FDIC. The amount of the assessment is based on the size of the bank's assessment base, which is equal to its average consolidated total assets less its average tangible equity, and its risk classification under an FDIC risk-based assessment system. Institutions assigned to higher risk classifications (that is, institutions that pose a higher risk of loss to the Deposit Insurance Fund) pay assessments at higher rates than institutions that pose a lower risk. An institution's risk classification is assigned based on its capital levels and the level of supervisory concern that the institution poses to the regulators. In addition, the FDIC can impose special assessments in certain instances. As noted above, the Dodd-Frank Act changed the way that deposit insurance premiums are calculated. Action by the FDIC to replenish the Deposit Insurance Fund when needed, as well as the changes contained in the Dodd-Frank Act, could result in higher assessment rates, which could reduce our profitability or otherwise negatively impact our operations.

Branching and Interstate Banking

Under federal law, the Bank is permitted to establish additional branch offices within Louisiana, subject to the approval of the OCC. As a result of the Dodd-Frank Act, the Bank may also establish additional branch offices outside of Louisiana, subject to prior regulatory approval, so long as the laws of the state where the branch is to be located would permit a state bank chartered in that state to establish a branch. The Bank may also establish offices in other states by merging with banks or by purchasing branches of other banks in other states, subject to certain restrictions.

Community Reinvestment Act

The Bank is required under the Community Reinvestment Act, or CRA, and related OCC regulations to help meet the credit needs of its communities, including low and moderate-income borrowers. In connection with its examination of the Bank, the OCC assesses our record of compliance with the CRA. The Bank's failure to comply with the provisions of the CRA could, at a minimum, result in denial of certain corporate applications, such as branches or mergers, or in restrictions on its or the Company's activities. The Bank received a "satisfactory" CRA rating on its most recent CRA examination. The CRA requires all FDIC-insured institutions to publicly disclose their rating.

Concentrated Commercial Real Estate Lending Regulations

The federal bank regulatory agencies have promulgated guidance governing financial institutions with concentrations in commercial real estate lending. The guidance provides that a bank has a concentration in commercial real estate lending if (i) total reported loans for construction, land development, and other land represent 100% or more of total capital or (ii) total reported loans secured by multifamily and nonfarm nonresidential properties and loans for construction, land development, and other land represent 300% or more of total capital and the bank's commercial real estate loan portfolio has increased 50% or more during the prior 36 months. Owner occupied loans are excluded from this second category. If a concentration is present, management must employ heightened risk management practices that address, among other things, board and management oversight and strategic planning, portfolio management, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing, and maintenance of increased capital levels as needed to support the level of commercial real estate lending. At December 31, 2019, the Company did not have a concentration in commercial real estate as defined by the regulatory guidance.

Financial Privacy and Cybersecurity Requirements

Federal law and regulations limit a financial institution's ability to share consumer financial information with unaffiliated third parties. Specifically, these provisions require all financial institutions offering financial products or services to retail customers to provide such customers with the financial institution's privacy policy and provide such customers the opportunity to "opt out" of the sharing of personal financial information with unaffiliated third parties. The sharing of information for marketing purposes is also subject to limitations. The Bank currently has a privacy protection policy in place.

Federal banking regulators regularly issue guidance regarding cybersecurity intended to enhance cyber risk management. A financial institution is expected to implement multiple lines of defense against cyber-attacks. Financial institutions are also expected to implement procedures designed to address the risks posed by potential cyber threats, and to allow the institution to respond and recover effectively after a cyber-attack. The Company has adopted procedures designed to comply with the regulatory cybersecurity guidance.

Consumer Laws and Regulations

The Bank is subject to numerous laws and regulations intended to protect consumers in transactions with the Bank, including, among others, laws regarding unfair, deceptive and abusive acts and practices, usury laws, and other federal consumer protection statutes. These federal laws include the ECOA, the Electronic Fund Transfer Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, the Real Estate Procedures Act of 1974, the S.A.F.E. Mortgage Licensing Act of 2008, the Truth in Lending Act and the Truth in Savings Act, among others. Many states and local jurisdictions have consumer protection laws analogous, and in addition, to those enacted under federal law. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits, making loans and conducting other types of transactions. Failure to comply with these laws and regulations could give rise to regulatory sanctions, customer rescission rights, action by state and local attorneys general and civil or criminal liability.

In addition, the Dodd-Frank Act created the Consumer Financial Protection Bureau that has broad authority to regulate and supervise retail financial services activities of banks and various non-bank providers. The Bureau has authority to promulgate regulations, issue orders, guidance and policy statements, conduct examinations and bring enforcement actions with regard to consumer financial products and services. In general, however, banks with assets of \$10 billion or less, such as the Bank, will continue to be examined for consumer compliance by their primary federal bank regulator.

Mortgage Lending Rules

The Dodd-Frank Act authorized the Consumer Financial Protection Bureau to establish certain minimum standards for the origination of residential mortgages, including a determination of the borrower's ability to repay. Under the Dodd-Frank Act, financial institutions may not make a residential mortgage loan unless they make a "reasonable and good faith determination" that the consumer has a "reasonable ability" to repay the loan. The Dodd-Frank Act allows borrowers to raise certain defenses to foreclosure but provides a full or partial safe harbor from such defenses for loans that are "qualified mortgages." The Bureau's rules, among other things, specify the types of income and assets that may be considered in the ability-to-repay determination, the permissible sources for verification, and the required methods of calculating the loan's monthly payments. The rules extend the requirement that creditors verify and document a borrower's income and assets to include all information that creditors rely on in determining repayment ability. The rules also provide further examples of third-party documents that may be relied on for such verification, such as government records and check cashing or funds transfer service receipts. The rules also define "qualified mortgages," imposing both underwriting standards and limits on the terms of their loans. Points and fees are subject to a relatively stringent cap, and the terms include a wide array of payments that may be made in the course of closing a loan. Certain loans, including interest-only loans and negative amortization loans, cannot be qualified mortgages.

Anti-Money Laundering and OFAC

Under federal law, financial institutions must maintain anti-money laundering programs that include: established internal policies, procedures and controls; a designated compliance officer; an ongoing employee training program; and testing of the program by an independent audit function. Financial institutions are also prohibited from entering into specified financial transactions and account relationships and must meet enhanced standards for due diligence and customer identification in their dealings with foreign financial institutions and foreign customers. Financial institutions must take reasonable steps to conduct enhanced scrutiny of account relationships to guard against money laundering and to report any suspicious transactions, and law enforcement authorities have been granted increased access to financial information maintained by financial institutions.

The Office of Foreign Assets Control, or OFAC, is responsible for helping to insure that U.S. entities do not engage in transactions with certain prohibited parties, as defined by various Executive Orders and Acts of Congress. OFAC publishes lists of persons and organizations suspected of aiding, harboring or engaging in terrorist acts, known as Specially Designated Nationals and Blocked Persons. Generally, if the Bank identifies a transaction, account or wire transfer relating to a person or entity on an OFAC list, it must freeze the account or block the transaction, file a suspicious activity report and notify the appropriate authorities.

Bank regulators routinely examine institutions for compliance with these obligations and they must consider an institution's compliance in connection with the regulatory review of applications, including applications for banking mergers and acquisitions. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing and comply with OFAC sanctions, or to comply with relevant laws and regulations, could have serious legal, reputational and financial consequences for the institution.

Safety and Soundness Standards

Federal bank regulatory agencies have adopted guidelines that establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation, fees and benefits. Additionally, the agencies have adopted regulations that provide the authority to order an institution that has been given notice by an agency that it is not satisfying any of these safety and soundness standards to submit a compliance plan. If, after being so notified, an institution fails to submit an acceptable compliance plan or fails in any material respect to implement an acceptable compliance plan, the agency must issue an order directing action to correct the deficiency and may issue an order directing other actions of the types to which an undercapitalized institution is subject under the "prompt corrective action" provisions of the Federal Deposit Insurance Act. If an institution fails to comply with such an order, the agency may seek to enforce such order in judicial proceedings and to impose civil money penalties.

Bank holding companies are also not permitted to engage in unsound banking practices. For example, the Federal Reserve's Regulation Y requires a holding company to give the Federal Reserve prior notice of any redemption or repurchase of its own equity securities, if the consideration to be paid, together with the consideration paid for any repurchases in the preceding year, is equal to 10% or more of the company's consolidated net worth. The Federal Reserve may oppose the transaction if it believes that the transaction would constitute an unsafe or unsound practice or would violate any law or regulation. As another example, a holding company could not impair its subsidiary bank's soundness by causing it to make funds available to non-banking subsidiaries or their customers if the Federal Reserve believed it not prudent to do so. The Federal Reserve has broad authority to prohibit activities of bank holding companies and their nonbanking subsidiaries that represent unsafe and unsound banking practices or that constitute violations of laws or regulations.

Effect of Governmental Monetary Policies

The commercial banking business is affected not only by general economic conditions but also by U.S. fiscal policy and the monetary policies of the Federal Reserve. Some of the instruments of monetary policy available to the Federal Reserve include changes in the discount rate on member bank borrowings, the fluctuating availability of borrowings at the “discount window,” open market operations, the imposition of and changes in reserve requirements against member banks’ deposits and assets of foreign branches, and the imposition of and changes in reserve requirements against certain borrowings by banks and their affiliates. These policies influence to a significant extent the overall growth of bank loans, investments, and deposits and the interest rates charged on loans or paid on deposits. We cannot predict the nature of future fiscal and monetary policies and the effect of these policies on our future business and earnings.

Future Legislation and Regulatory Reform

New laws, regulations and policies are regularly proposed that contain wide-ranging proposals for altering the structures, regulations and competitive relationships of financial institutions operating in the United States. In addition, existing laws, regulations and policies are continually subject to modification or changes in interpretation. We cannot predict whether or in what form any law, regulation or policy will be adopted or modified or the extent to which our operations and activities, financial condition, results of operations, growth plans or future prospects may be affected by its adoption or modification.

The cumulative effect of these laws and regulations add significantly to the cost of our operations and thus have a negative impact on profitability. There has also been a tremendous expansion in recent years of financial service providers that are not subject to the same level of regulation, examination and oversight as we are. Those providers, because they are not so highly regulated, may have a competitive advantage over us and may continue to draw large amounts of funds away from traditional banking institutions, with a continuing adverse effect on the banking industry in general.

Employees

As of December 31, 2019, we had 324 full-time equivalent employees. None of our employees are represented by any collective bargaining unit or are parties to a collective bargaining agreement. We believe that our relations with our employees are good.

Dependence upon a Single Customer

No material portion of our loans has been made to, nor have our deposits been obtained from, a single or small group of customers; the loss of any single customer or small group of customers would not have a materially adverse effect on our business. A discussion of concentrations of credit in our loan portfolio is set forth under the heading *Loan Concentrations* in “Discussion and Analysis of Financial Condition—Loans” in *Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations*.

Available Information

Our filings with the Securities and Exchange Commission (the “SEC”), including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments thereto, are available on our website as soon as reasonably practicable after the reports are filed with or furnished to the SEC. Copies can be obtained free of charge in the “Investor Relations” section of our website at www.investarbank.com. Our SEC filings are also available through the SEC’s website www.sec.gov. Copies of these filings are also available by writing to us at the following address:

Investar Holding Corporation
P.O. Box 84207
Baton Rouge, Louisiana 70884-4207

Item 1A. Risk Factors

Our business is subject to risk. In addition to the other information contained in this Annual Report on Form 10-K, including management's discussion and analysis of financial condition and results of operations and our financial statements and the notes thereto, investors should consider the following risks when evaluating whether to invest in our common stock. If any of the following risks occur, whether alone or in combination, our business, financial condition, results of operations, cash flows and growth prospects could be materially and adversely affected. Additional risks that we do not presently know of or currently deem immaterial may also adversely affect our business, financial condition, results of operations cash flows and growth prospects.

Risks Related to our Business

As a business operating in the financial services industry, our business and operations may be adversely affected by current economic conditions and geopolitical matters.

Our financial performance generally, and in particular the ability of borrowers to pay interest on and repay principal of outstanding loans and the value of collateral securing those loans, as well as demand for loans and other products and services we offer, is highly dependent upon the business environment in the primary markets where we operate and in the U.S. as a whole. Unfavorable or uncertain economic and market conditions can be caused by declines in economic growth, business activity or investor or business confidence, limitations on the availability or increases in the cost of credit and capital, increases in inflation or interest rates, high unemployment, natural disasters, pandemics or fear of pandemics, or a combination of these or other factors. As of December 31, 2019, our primary markets were south Louisiana (approximately 86% of our total deposits of \$1.7 billion), southeast Texas (approximately 7% of our total deposits) and west Alabama (approximately 7% of our total deposits). We also had pending our acquisition of Cheaha Financial Group, Inc., with approximately \$179.0 million in deposits in east Alabama as of December 31, 2019.

Since January 2020, the coronavirus outbreak which has spread to many countries including the U.S., and the fear of further spread of the coronavirus, have caused significant disruption in the international and U.S. economies and financial markets. Further spread of the coronavirus could cause additional quarantines, cancellation of events and travel, business and school shutdowns, reduction in business activity and financial transactions, labor shortages, supply chain interruptions and overall economic and financial market instability. Accordingly, further spread, or the fear of further spread, of the coronavirus could have a material adverse effect on our business in many ways, including but not limited to by reducing customer's willingness to enter into loans, impairing the ability of our borrowers to repay their loans, reducing the value of collateral securing the loans, and disrupting our operations, which could have a material adverse impact on our business, financial conditions, results of operations and cash flows.

While economic conditions in our primary markets of south Louisiana, southeast Texas, and, following our recent acquisition of Bank of York, west Alabama, generally have improved after the end of the most recent economic recession in 2009, concerns exist regarding the strength and length of the recovery. A return of recessionary conditions and/or negative developments in the domestic and international credit markets may significantly affect the markets in which we do business, the value of our loans and investments, and our ongoing operations, costs and profitability. Declines in real estate value and sales volumes and high unemployment levels may result in higher than expected loan delinquencies and a decline in demand for our products and services. These negative events may cause us to incur losses and may adversely affect our capital, liquidity and financial condition.

In addition, geopolitical matters, including international political unrest, disruptions in international trade patterns, and slow growth in sectors of the global economy, as well as acts of terrorism, war and other violence could result in disruptions or volatility in the financial markets, which could reduce the value of our assets or reduce liquidity. These negative events could have a material adverse effect on our results of operations and financial condition, including our liquidity position, and may affect our ability to access capital.

Our business strategy includes the continuation of our multi-state growth plans, and our financial condition and results of operations could be negatively affected if we fail to grow or fail to manage our growth effectively.

We have grown our business primarily through de novo branching and through the acquisition of other financial institutions. Since our bank was founded in June 2006, through December 31, 2019, we have opened 12 de novo branches and completed six whole bank acquisitions. As of December 31, 2019, we had pending the acquisition of Cheaha Financial Group, Inc., with four branch locations in Calhoun County, Alabama, and the acquisition of two branch locations in the Texas cities of Alice and Victoria from PlainsCapital Bank, which was completed on February 21, 2020. During 2019, we expanded our operations outside our historical south Louisiana base and into Texas and Alabama, progressing towards our goal to build a premier regional community bank. We intend to continue pursuing a multi-state growth strategy for our business through de novo branching and to evaluate attractive acquisition opportunities that are presented to us. Our growth prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies when expanding their franchise, including the following:

- ***Management of Growth.*** We may be unable to successfully maintain loan quality in the context of significant loan growth or maintain adequate management personnel and systems to oversee such growth, including internal audit, loan review and compliance personnel. Our growth may require that we implement additional policies, procedures and operating systems, and we may encounter difficulties in doing so at all or in a timely manner.
- ***Operating Results.*** There is no assurance that existing offices or future offices will maintain or achieve deposit levels, loan balances or other operating results necessary to avoid losses or produce profits. Our growth and de novo branching strategy necessarily entails growth in overhead expenses as we routinely add new offices and staff. Our historical results may not be indicative of future results or results that may be achieved as we continue to increase the number and concentration of our branch offices. Should any new location be unprofitable or marginally profitable, or should any existing location experience a decline in profitability or incur losses, the adverse effect on our results of operations and financial condition could be more significant than would be the case for a larger company.
- ***De Novo Branching; Branch Acquisitions.*** There are considerable costs involved in opening branches, and new branches generally do not generate sufficient revenues to offset their costs until they have been in operation for at least a year or more. Accordingly, our de novo branches can be expected to negatively impact our earnings for some period of time until the branches reach certain economies of scale. Our expenses could be further increased if we encounter delays in opening any of our de novo branches. We may be unable to accomplish future de novo branch expansion plans due to a lack of available satisfactory sites, difficulties in acquiring such sites, increased expenses or loss of potential sites due to complexities associated with zoning and permitting processes, or other factors. We may also be unable to identify and acquire suitable operating branches. Finally, we have no assurance our de novo branches or branches that we may acquire will be successful even after they have been established or acquired, as the case may be. During the last three fiscal years, we have opened five de novo branches, and we expect to open two de novo branches in 2020.
- ***Expansion into New Markets.*** As we grow into new markets in Louisiana, Texas, Alabama and potentially in other states, we are likely to encounter customer demographics and financial services offerings unlike those found in our current markets. In these markets we are likely to face competition from a wide array of financial institutions, including much larger, better-established financial institutions. Competition for qualified personnel in these markets may be intense, and there may be a limited number of qualified persons with knowledge of and experience in the commercial banking industry in these markets. Even if we identify individuals that we believe could assist us in establishing a presence in a new market, we may be unable to recruit these individuals away from other banks or may be unable to do so at a reasonable cost. In addition, we may face difficulties in identifying and gaining access to customers. Prior to our acquisition of Mainland in the first quarter of 2019, we operated exclusively in Louisiana. With our acquisition of Mainland, we entered Texas, and we subsequently entered Alabama with our acquisition of Bank of York in November 2019. The financial services industry in these areas is highly competitive, and the challenges of operating in three states may be greater than we anticipate.

Failure to successfully address these issues could have a material adverse effect on our financial condition and results of operations, and could adversely affect our ability to successfully implement our business strategy. Also, if our growth occurs more slowly than anticipated or declines, our operating results could be materially adversely affected.

Our success depends significantly on our management team, and the loss of our senior executive officers or other key employees and our inability to recruit or retain suitable replacements could adversely affect our business, results of operations and growth prospects.

Our success depends significantly on the continued service and skills of our existing executive management team. The implementation of our business and growth strategies also depends significantly on our ability to retain employees with experience and business relationships within their respective market areas, as well as on our ability to attract, motivate and retain highly qualified senior and middle management. We do not have employment agreements with any of our executive officers, and they may terminate their employment with us at any time. Competition for employees is intense, and we could have difficulty replacing such officers with personnel with the combination of skills and attributes required to execute our business and growth strategies and who have ties to the communities within our market areas. The loss of any of our key personnel could therefore have a material adverse effect on our business, financial condition, results of operations and growth prospects.

As a community bank, our ability to maintain our reputation is critical to the growth of our business.

We are a community bank and our reputation is one of the most valuable components of our business. Much of our growth over the past several years has depended on attracting new customers from competing financial institutions and increasing our market share, primarily through the involvement of our employees in the communities that we serve. In addition, our ability to attract and retain highly-skilled management and employees is impacted by our reputation. A negative public opinion of our business can result from any number of activities, including our lending practices, corporate governance, and regulatory compliance, acquisitions, and actions taken by our regulators or by community organizations in response to these activities. Significant harm to our reputation could also arise as a result of regulatory or governmental actions, litigation, employee misconduct, or the activities of our customers, other participants in the financial services industry or our contractual counterparties, such as our service providers and vendors. In addition, a cybersecurity event impacting us or our customers' data could have a negative impact on our reputation and could materially damage our customers' confidence in, and willingness to do business with, us. Damage to our reputation could also adversely affect our credit ratings and access to capital markets.

Our business is concentrated in southern Louisiana, southeast Texas, and western Alabama, and an economic downturn affecting these areas may magnify the adverse effects and consequences to us.

We currently conduct our operations primarily in southern Louisiana, and more specifically, in the Baton Rouge, New Orleans and Lafayette metropolitan areas and in the greater Houston, Texas area. In November 2019, we entered western Alabama with our acquisition of Bank of York and currently have pending our acquisition of Cheaha Financial Group, Inc. in eastern Alabama. At December 31, 2019, approximately 69% of the secured loans in our total loan portfolio were secured by properties and other collateral located in Louisiana, while approximately 62% of the loans in our loan portfolio (measured by dollar amount) were made to borrowers who live or work in either the Baton Rouge, New Orleans or Lafayette metropolitan areas. At December 31, 2019, approximately 3% of the secured loans in our total loan portfolio were secured by properties and other collateral located in Texas, and 3% were secured by properties and other collateral located in Alabama. Our pending acquisition of Cheaha Financial Group, Inc., if completed, would more than double our loans secured by properties and other collateral in Alabama. This geographic concentration imposes a greater risk to us than to our competitors in the area who maintain significant operations outside of our selected markets. Accordingly, any regional or local economic downturn, or natural or man-made disaster, that affects southern Louisiana, southeast Texas, Alabama, or existing or prospective property or borrowers in such areas may affect us and our profitability more significantly and more adversely than our more geographically diversified competitors. Deterioration in economic conditions in the markets we serve could result in one or more of the following:

- an increase in loan delinquencies;
- an increase in problem assets and foreclosures;
- a decrease in the demand for our products and services;
- a decrease in the value of collateral for loans, especially real estate, in turn reducing our customers' borrowing power, the value of assets associated with problem loans and collateral coverage; and/or
- a decrease in supply of customer deposits, which could impact our liquidity.

More particularly, much of our business development and marketing strategy is directed toward fulfilling the banking and financial services needs of small to medium-sized businesses. Such businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities. If general economic conditions negatively impact our selected markets and these businesses are adversely affected, our financial condition and results of operations may be negatively affected.

Adverse economic factors affecting particular industries could have a negative effect on our customers and their ability to make payments to us.

In addition to the geographic concentration of our markets, certain industry-specific economic factors also affect us. For example, a downturn in segments of the commercial and residential real estate industries in our markets due to adverse economic factors affecting particular industries could have an adverse effect on our customers. In addition, the energy sector, which is historically cyclical, has experienced significant volatility and a decline in oil and gas prices. For example, Brent crude prices declined from highs above \$100 per barrel in mid-2014 to lows below \$40 per barrel in late 2015 and early 2016. Prices generally rose to levels above \$70 per barrel in the third quarter of 2018 before declining to close at \$50.57 at the end of 2018, and closed at \$35.79 on March 11, 2020. While we consider our exposure to the energy sector to not be significant, comprising approximately 3.7% of total loans at December 31, 2019, should the price of oil and gas decline further and/or remain at a low price for an extended period, the general economic conditions particularly in our south Louisiana and southeast Texas markets could be negatively affected, which could have a material adverse effect on our business, financial condition, and results of operations.

We have a significant number of loans secured by real estate, and a downturn in the real estate market could result in losses and negatively impact our profitability.

At December 31, 2019, approximately 79% of our total loan portfolio had real estate as a primary or secondary component of the collateral securing the loan. The real estate provides an alternate source of repayment in the event of a default by the borrower but its value may deteriorate during the time the credit is extended. Declines in real estate values in our markets could significantly impair the value of the particular collateral securing our loans and our ability to sell the collateral upon foreclosure for an amount necessary to satisfy the borrower's obligations to us. Furthermore, in a declining real estate market, we often will need to further increase our allowance for loan losses to address the deterioration in the value of the real estate securing our loans. Any of the foregoing could have a material adverse effect on our business, financial condition, results of operations, cash flows and growth prospects.

Commercial real estate loans may expose us to greater risks than our other real estate loans.

Our loan portfolio includes commercial real estate loans, which are secured by owner-occupied and nonowner-occupied commercial properties. As of December 31, 2019, our owner-occupied commercial real estate loans totaled \$352.3 million, or 21% of our total loan portfolio and our nonowner-occupied commercial real estate loans totaled \$378.7 million, or 22% of our total loan portfolio.

Commercial real estate loans typically depend on cash flows from the property to service the debt. Cash flows, either in the form of rental income or the proceeds from sales of commercial real estate, may be affected significantly by general economic conditions. Weak economic conditions may impair the borrower's business operations and typically slow the execution of new leases. Such economic conditions may also lead to existing lease turnover. As a result of these factors, vacancy rates for retail, office and industrial space may increase. High vacancy rates could also result in rents falling. The combination of these factors could result in deterioration in the fundamentals underlying the commercial real estate market and the deterioration in value of some of our loans. These loans expose a lender to greater credit risk than loans secured by residential real estate because the collateral securing these loans typically cannot be liquidated as easily as residential real estate. If we foreclose on these loans, our holding period for the collateral typically is longer than for a one-to-four family residential property because there are fewer potential purchasers of the collateral. Additionally, nonowner-occupied commercial real estate loans generally involve relatively large balances to single borrowers or related groups of borrowers. Accordingly, charge-offs on nonowner-occupied commercial real estate loans may be larger on a per loan basis than those incurred with our residential or consumer loan portfolios. Unexpected deterioration in the credit quality of our commercial real estate loan portfolio would require us to increase our provision for loan losses, which would reduce our profitability and could materially adversely affect our business, financial condition, results of operations, cash flows and growth prospects.

Our portfolio of commercial and industrial loans has grown as a proportion of our total loans, and may expose us to greater risk than other loans.

Our portfolio of commercial and industrial loans has grown from 11% of total loans at December 31, 2017 to 19% at December 31, 2019. These loans primarily consist of working capital lines of credit and equipment loans, typically secured by accounts receivable or inventory, or the relevant equipment. Repayment of these loans generally comes from the generation of cash flow as the result of the borrower's business operations. Commercial lending generally involves different risks from those associated with commercial real estate lending or construction lending. Although commercial loans may be collateralized by business assets (including real estate, if available as collateral), the repayment of these types of loans depends primarily on the creditworthiness and projected cash flow of the borrower (and any guarantors). Thus, the general business conditions of the local economy and the borrower's ability to sell its products and services, thereby generating sufficient operating revenue to repay us under the agreed

upon terms and conditions, are the chief considerations when assessing the risk of a commercial and industrial loan. The liquidation of collateral, if any, is considered a secondary source of repayment because equipment and other business assets may, among other things, be obsolete or of limited resale value.

Our allowance for loan losses may prove to be insufficient to absorb losses inherent in our loan portfolio, and we may be required to further increase our provision for loan losses.

Our business depends on our ability to successfully measure and manage credit risk. As a lender, we are exposed to the risk that the principal of and interest on a loan will not be paid timely or at all and that the value of any collateral supporting a loan will be insufficient to cover any exposure to loss on a loan. Management maintains an allowance for loan losses, which is a reserve established through a provision for loan losses charged to expense, to absorb probable credit losses inherent in the entire loan portfolio. We maintain our allowance for loan losses at a level considered adequate by management to absorb probable loan losses, including collateral impairment, based on our analysis of our portfolio and market environment, using relevant information available to us. Among other considerations in establishing the allowance for loan losses, management considers economic conditions reflected within industry segments, the unemployment rate in our markets, loan segmentation and historical losses that are inherent in the loan portfolio.

As of December 31, 2019, our allowance for loan losses as percentages of total loans and nonperforming loans was 0.63% and 171.1%, respectively. The determination of the appropriate level of the allowance is inherently subjective, involves a high degree of judgment and complexity, and requires us to make significant estimates of current credit risks and future trends, all of which are subject to material changes. In addition, loans acquired in connection with business combination transactions are measured at fair value, based on management's estimates related to expected prepayments and the amount and timing of undiscounted expected principal, interest and other cash flows. Because fair value measurements incorporate assumptions regarding credit risk, no allowance for loan losses related to the acquired loans is recorded on the acquisition date.

Inaccurate management assumptions, including with respect to the fair value of acquired loans, continuing deterioration of economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require us to increase our allowance for loan losses. In addition, bank regulatory agencies periodically review the allowance for loan losses and may require an increase in the provision for loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. Finally, if actual charge-offs in future periods exceed the allowance for loan losses, we will need additional provisions to increase the allowance for loan losses. Any increases in the allowance for loan losses will result in a decrease in net income and, possibly, capital and may have a material adverse effect on our business, financial condition, results of operations and growth prospects.

Commercial and industrial and commercial real estate loans generally are viewed as having more risk of default than residential real estate loans or other loans or investments. These types of loans are also typically larger than residential real estate loans and other consumer loans. Because the loan portfolio contains a significant number of commercial and industrial and commercial real estate loans with relatively large balances, the deterioration of a material amount of these loans may cause a significant increase in our allowance for loan losses, non-performing assets, TDRs and/or past due loans. An increase in our allowance for loan losses, non-performing assets, TDRs, and/or past due loans could result in a loss of earnings, or an increase in loan charge-offs, which would have an adverse impact on our results of operations and financial condition.

In addition, in June 2016, the Financial Accounting Standards Board ("FASB") issued a new accounting standard (ASU No. 2016-13), referred to as Current Expected Credit Loss ("CECL") that requires that the measurement of all expected credit losses for financial assets held at the reporting date be based on historical experience, current conditions, and reasonable and supportable forecasts, and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. In addition, the new standard amends the accounting for credit losses on purchased financial assets with credit deterioration. We are currently evaluating the potential impact of this new accounting standard on our financial statements. The adoption of ASU 2016-13 is likely to result in an increase in the allowance for loan losses as a result of changing from an "incurred loss" model, which encompasses allowances for current known and inherent losses within the portfolio, to an "expected loss" model, which encompasses allowances for losses expected to be incurred over the life of the portfolio. While we are currently unable to reasonably estimate the impact of adopting ASU 2016-13, we expect that the impact of adoption will be significantly influenced by the composition, characteristics and quality of our loan portfolio, as well as the prevailing economic conditions and forecasts, as of the adoption date. This amendment was originally effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, but the FASB has since delayed the effective date such that ASU 2016-13 will currently be effective for us, as a smaller reporting company, on January 1, 2023. We expect to adopt the standard as soon as practicable, based upon progress on our implementation plan. Adoption prior to the revised effective date of January 1, 2023 is permitted by the ASU.

In December 2018, the FDIC, Federal Reserve and Office of the Comptroller of the Currency issued a final rule to allow a banking organization to elect to phase in the regulatory capital impact over a three-year period commencing with time of adoption of the new standard. A failure to effectively measure the impact of the new CECL standard may result in significant overstatement or understatement of our allowance for loan and lease losses, and in the event of an understatement, may necessitate that we significantly increase our allowance for loan and lease losses, which could adversely affect our net income.

Lack of seasoning of our loan portfolio could increase the risk of future credit defaults.

As a result of our growth over the past three years, a large portion of loans in our loan portfolio and of our lending relationships are of relatively recent origin. In general, loans do not begin to show signs of credit deterioration or default until they have been outstanding for some period of time, a process referred to as “seasoning.” As a result, a portfolio of older loans will usually behave more predictably than a newer portfolio. Because a large portion of our portfolio is relatively new, the current level of delinquencies and defaults may not represent the level that may prevail as the portfolio becomes more seasoned. If delinquencies and defaults increase, we may be required to increase our provision for loan losses, which could materially adversely affect our business, financial condition, results of operations and growth prospects.

New lines of business or new products and services may subject the Company to additional risks.

From time to time, the Company may implement or may acquire new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and/or new products and services, the Company may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives and shifting market preferences, may also impact the successful implementation of a new line of business or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of the Company’s system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business or new products or services could have a material adverse effect on the Company’s business, financial condition, and results of operations.

Changes in interest rates could have an adverse effect on our profitability.

The majority of our assets and liabilities are monetary in nature and, as a result, we are subject to significant risk from changes in interest rates. Changes in interest rates may affect our net interest income as well as the valuation of our assets and liabilities. We cannot predict with certainty changes in interest rates, which are affected by many factors beyond our control, including inflation, recession, unemployment, money supply, competition for loans and deposits, domestic and international events, changes in the United States and other financial markets and the policies of the Federal Reserve. Our earnings depend significantly on our net interest income, which is the difference between interest income on interest-earning assets, such as loans and securities, and interest expense on interest-bearing liabilities, such as deposits and borrowings. We expect to periodically experience “gaps” in the interest rate sensitivities of our assets and liabilities, meaning that either our interest-bearing liabilities will be more sensitive to changes in market interest rates than our interest-earning assets, or vice versa. In either event, if market interest rates move contrary to our position, this “gap” may work against us, and our earnings may be adversely affected.

When interest-bearing liabilities mature or reprice more quickly, or to a greater degree than interest-earning assets in a period, an increase in interest rates could reduce net interest income. Similarly, when interest-earning assets mature or reprice more quickly, or to a greater degree than interest-bearing liabilities, falling interest rates could reduce net interest income. Additionally, an increase in the general level of interest rates may also, among other things, adversely affect our current borrowers’ ability to repay variable rate loans, the demand for loans and our ability to originate loans and decrease loan prepayment rates, or could increase the cost of the Company’s deposits. Conversely, a decrease in the general level of interest rates, among other things, may lead to prepayments on our loan and mortgage-backed securities portfolios, which could result in decreased yields on earning assets. Volatility in interest rates may increase competition for deposits, and raise the cost of deposits. Accordingly, changes in the general level of market interest rates may adversely affect our net yield on interest-earning assets, loan origination volume and our overall results.

Although our asset-liability management strategy is designed to control and mitigate exposure to the risks related to changes in the general level of market interest rates, those rates are affected by many factors outside of our control, including inflation, recession, unemployment, money supply, international disorder, instability in domestic and foreign financial markets and policies of various governmental and regulatory agencies, particularly the Board of Governors of the Federal Reserve. Adverse changes in the U.S. monetary policy or in economic conditions could materially and adversely affect us. We may not be able to accurately predict the likelihood, nature and magnitude of those changes or how and to what extent they may affect our business. We also may not be able to adequately prepare for or compensate for the consequences of such changes. Any failure to predict and prepare for changes in interest rates or adjust for the consequences of these changes may adversely affect our earnings and capital levels and overall results.

In addition, as interest rates increase, the ability of borrowers to repay their current loan obligations could be negatively impacted, which would adversely affect our results of operations. These circumstances could not only result in increased loan defaults, foreclosures and charge-offs but also necessitate further increases to the allowance for loan losses. At the same time, the marketability of the property securing a loan may be adversely affected by any reduced demand resulting from higher interest rates. Further, when we place a loan on nonaccrual status, we reverse any accrued but unpaid interest receivable, which decreases interest income, but we continue to have a cost to fund the loan, which is reflected as interest expense, without any interest income to offset the associated funding expense. Thus, an increase in the amount of nonperforming assets would have an adverse impact on net interest income. On the other hand, in a declining interest rate environment, there may be an increase in prepayments on loans as borrowers refinance their loans at lower rates. For additional information, see *Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations - Risk Management - Interest Rate Risk*.

Changes in the method pursuant to which the LIBOR and other benchmark rates are determined could adversely impact our business and results of operations.

Our floating-rate funding, certain hedging transactions and certain of the products we offer, such as floating-rate loans, determine their applicable interest rate or payment amount by reference to a benchmark rate, such as LIBOR, or to an index, currency, basket or other financial metric. LIBOR and certain other benchmark rates are the subject of recent national, international, and other regulatory guidance and proposals for reform. In July 2017, the Chief Executive of the Financial Conduct Authority announced that the Financial Conduct Authority intends to stop persuading or compelling banks to submit rates for the calculation of LIBOR after 2021. This announcement indicates that the continuation of LIBOR on the current basis cannot and will not be guaranteed after 2021. Consequently, at this time, it is not possible to predict whether and to what extent banks will continue to provide submissions for the calculation of LIBOR. Similarly, it is not possible to predict whether LIBOR will continue to be viewed as an acceptable market benchmark, what rate or rates may become accepted alternatives to LIBOR, or what the effect of any such changes in views or alternatives may be on the markets for LIBOR-linked financial instruments. Certain of our LIBOR-based financial products and contracts, including, but not limited to, hedging products, debt obligations, investments and loans, extend beyond 2021. We are in the process of assessing the impact that a cessation or market replacement of LIBOR would have on these various products and contracts.

Loss of deposits or a change in deposit mix could increase the Company's funding costs.

Deposits are a low cost and stable source of funding. We compete with banks and other financial institutions for deposits. Funding costs could increase if the Company loses deposits and replaces them with more expensive sources of funding, customers may shift their deposits into higher cost products, or the Company may need to raise its interest rates to avoid losing deposits. Higher funding costs reduce the Company's net interest margin, net interest income and net income.

By engaging in derivative transactions, we are exposed to credit and market risk, which could adversely affect our profitability and financial condition.

We manage interest rate risk by utilizing derivative instruments, such as interest rate swap contracts, to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. Hedging interest rate risk is a complex process, requiring sophisticated models and constant monitoring. The effect of this unrealized appreciation or depreciation will generally be offset by income or loss on the derivative instruments that are linked to the hedged assets and liabilities. By engaging in derivative transactions, we are exposed to credit and market risk. If the counterparty fails to perform, credit risk exists to the extent of the fair value gain in the derivative instrument. Market risk exists to the extent that interest rates change in ways that are significantly different from what was expected when we entered into the derivative agreement. The existence of credit and market risk associated with our derivative instruments could adversely affect our profitability and financial condition.

Hurricanes or other adverse weather conditions, as well as man-made disasters, could negatively affect our local markets or disrupt our operations, which may adversely affect our business and results of operations.

Our business is concentrated in southern Louisiana, in the greater Houston, Texas area, and in west Alabama. Our selected markets are susceptible to major hurricanes, floods, tropical storms, tornadoes and other natural disasters and adverse weather, the nature and severity of which can be difficult to predict. These natural disasters can disrupt our operations, cause widespread property damage and severely depress the local economies in which we operate. For example, Hurricane Gustav in 2008 severely impacted our headquarters city of Baton Rouge, with power in many areas of the city not being restored for nearly three weeks after the hurricane. In addition, Hurricane Katrina in August 2005 and the historic flooding of Baton Rouge and surrounding areas in August 2016 had significant impacts in several markets in which we conduct business. Hurricane Harvey caused significant damage and flooding in Texas when it made landfall in August 2017. The severity and impact of future severe weather events are difficult to predict and may be exacerbated by global climate change. The 2010 Deepwater Horizon oil spill in the Gulf of Mexico illustrated that man-made disasters can also adversely affect economic activity in the markets in which we operate. Any economic decline as a result of a natural disaster, adverse weather, oil spill or other man-made disaster can reduce the demand for loans and our other products and services.

Such events could also affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans (resulting in increased delinquencies, foreclosures and loan losses), impair the value of collateral securing such loans, cause significant property damage, result in loss of revenue and/or cause us to incur additional expenses. The occurrence of any such event could, therefore, result in decreased revenue and loan losses that have a material adverse effect on our business, financial condition, results of operations and growth prospects.

We are subject to a variety of risks in connection with any sale of loans we may conduct.

We have historically sold certain mortgage loans that we originate as well as pools of our consumer loans. In connection with these sales, we are typically required to make representations and warranties to the purchaser about the loans sold and the procedures under which those loans have been originated. If these representations and warranties are incorrect, we may be required to indemnify the purchaser for its losses or we may be required to repurchase part or all of the affected loans. Borrower fraud may also cause us to have to repurchase loans that we have sold. If we are required to make any indemnity payments or repurchases and do not have a remedy available to us against a solvent counterparty, we may not be able to recover our losses resulting from these indemnity payments and repurchases. Consequently, our results of operations may be adversely affected.

We may need to raise additional capital in the future to execute our business strategy.

In addition to the liquidity that we require to conduct our day-to-day operations, the Company, on a consolidated basis, and the Bank, on a stand-alone basis, must meet regulatory requirements. Also, we may need capital to finance our growth, including through acquisitions. During 2019, we sold \$25.0 million of subordinated notes structured to qualify as tier 2 capital, and \$30.0 million of common stock, in part to fund acquisitions.

Our ability to raise additional capital depends on conditions in the capital markets, economic conditions and a number of other factors, including investor perceptions regarding the banking industry, market conditions and governmental activities, and on our financial condition and performance. Accordingly, there can be no assurances that we will be able to raise additional capital if needed or on terms acceptable to us. If we fail to maintain capital to meet regulatory requirements, our business, financial condition, results of operations and growth prospects could be materially and adversely affected.

Competition in our industry is intense, which could adversely affect our growth and profitability.

We face substantial competition in all areas of our operations from a variety of different competitors, many of which are larger and have substantially greater resources than we have, including higher total assets and capitalization, a more extensive and established branch network, greater access to capital markets and a broader offering of financial services. Such competitors primarily include national, regional and community banks within the various markets in which we operate. Because of their scale, many of these competitors can be more aggressive than we can on loan and deposit pricing. We also face competition from many other types of financial institutions, including savings and loans, credit unions, finance companies, brokerage firms, insurance companies, factoring companies and other financial intermediaries. Many of these entities have fewer regulatory constraints and may have lower cost structures than we do.

Our industry could become even more competitive as a result of legislative and regulatory changes as well as continued consolidation. The increased regulatory requirements imposed on financial institutions as well as the economic downturn in the United States in the 2007-2009 time frame, and generally slow recovery thereafter, have already resulted in the consolidation of a number of financial institutions, in addition to acquisitions of failed institutions. We expect additional consolidation to occur. Finally, technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Our ability to compete successfully depends on a number of factors, including customer convenience, quality of service, personal contacts, pricing and range of products. If we are unable to successfully compete, our business, financial condition, results of operations and growth prospects will be materially adversely affected.

Our integration of the operations of recently acquired companies may be more difficult, costly or time-consuming than expected, and the anticipated benefits and cost savings of these acquisitions by the Company may not be realized.

The acquisition component of the Company's growth strategy depends on the successful integration of our acquisitions. During 2019, we completed the acquisitions of Mainland and Bank of York, and on December 20, 2019 announced the pending acquisition of Cheaha. Additionally, on February 21, 2020, we completed the acquisition and assumption of certain assets and liabilities of two PlainsCapital Bank branches. The acquisition of Mainland represented the Company's first expansion outside Louisiana, and the acquisition of Bank of York was the Company's first expansion into Alabama. Prior to the closing of an acquisition, the Company and acquired business operated independently from each other. The success of the acquisitions or proposed acquisitions, including anticipated benefits and cost savings, will depend, in part, on the Company's ability to successfully combine and integrate the businesses within the Company's projected timeframe in a manner that permits growth opportunities and does not materially disrupt existing customer relationships or result in decreased revenues due to loss of customers.

A number of factors could affect the Company's ability to successfully combine its business with acquired businesses, including the following:

- the potential for unexpected costs, delays and challenges that may arise in integrating the acquisition into the Company's existing business;
- unexpected obstacles to the Company's ability to realize the expected cost savings and synergies from the acquisition;
- the Company's ability to retain key employees and maintain relationships with significant customers and depositors of the acquired business;
- diversion of management's attention and resources during integration efforts;
- challenges related to operating at new locations and in two new states; and
- discovery following the acquisition of previously unknown liabilities associated with the acquired business.

If the Company encounters significant difficulties in the integration process, the anticipated benefits of the acquisitions or any proposed acquisition may not be realized fully, or at all, or may take longer to realize than expected. Failure to achieve the anticipated benefits of the acquisition or proposed acquisition in the timeframes projected by the Company could result in increased costs and decreased revenues. This could have a dilutive effect on the combined company's earnings per share. If the Company is unable to successfully integrate the business it acquires, the Company's business, financial condition and results of operations may be materially adversely affected.

We may face risks with respect to future acquisitions.

When we attempt to expand our business in Louisiana, Texas, Alabama and potentially other states through mergers and acquisitions, we seek targets that are culturally similar to us, have experienced management, have relationship-based business models, have minimal legacy credit issues and possess either significant market presence or have potential for improved profitability through economies of scale or expanded services. In addition to the general risks associated with our growth plans highlighted above, acquiring other banks, businesses or branches involves various risks commonly associated with acquisitions, including, among other things:

- the time and costs associated with identifying and evaluating potential acquisition and merger targets;
- inaccuracies in the estimates and judgments used to evaluate credit, operations, management and market risks with respect to the target institution;
- the time and costs of evaluating new markets, hiring experienced local management and opening new bank locations, and the time lags between these activities and the generation of sufficient assets and deposits to support the costs of the expansion;

- our ability to finance an acquisition and possible dilution to our existing shareholders;
- the diversion of our management's attention to the negotiation of a transaction;
- the incurrence of an impairment of goodwill associated with an acquisition and adverse effects on our results of operations;
- entry into new markets where we lack experience; and
- risks associated with integrating the operations and personnel of the acquired business in a manner that permits growth opportunities and does not materially disrupt existing customer relationships or result in decreased revenues resulting from any loss of customers.

With respect to the risks particularly associated with the integration of an acquired business, we may encounter a number of difficulties, such as:

- customer loss and revenue loss;
- the loss of key employees;
- the disruption of our operations and business;
- our inability to achieve expected cost savings and synergies;
- our inability to maintain and increase competitive presence;
- greater than expected negative effects of any divestitures required by regulatory authorities;
- possible inconsistencies in standards, control procedures and policies; and/or
- unexpected problems with operations, personnel, technology, credit and costs, or reduced cost savings.

In addition to the risks posed by the integration process itself, the focus of management's attention and effort on integration may result in a lack of sufficient management attention to other important issues, causing harm to our business. Also, general market and economic conditions or governmental actions affecting the financial industry generally may inhibit our successful integration of an acquired business.

We expect to continue to evaluate merger and acquisition opportunities that are presented to us and conduct due diligence activities related to possible transactions with other financial institutions. As a result, merger or acquisition discussions and, in some cases, negotiations may take place and future mergers or acquisitions involving cash, debt or equity securities may occur at any time. Historically, acquisitions of non-failed financial institutions involve the payment of a premium over book and market values, and, therefore, some dilution of our book value and net income per common share may occur in connection with any future transaction. Failure to realize the expected revenue increases, cost savings, increases in geographic or product presence and/or other projected benefits from an acquisition could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

The Company may not be able to complete announced acquisitions.

We must generally satisfy a number of meaningful conditions before we can complete an announced acquisition of another bank or bank holding company, including federal and/or state regulatory approvals. In determining whether to approve a proposed bank or bank holding company acquisition, bank regulators will consider, among other factors, the effect of the acquisition on competition, financial condition and future prospects, including current and projected capital ratios and levels, the competence, experience and integrity of management and record of compliance with laws and regulations, the convenience and the needs of the communities to be served. We cannot be certain when or if, or on what terms and conditions, any required regulatory approvals will be granted. In specific cases, we may be required to sell banks or branches, or take other actions as a condition to receiving regulatory approval. An inability to satisfy other conditions necessary to consummate an acquisition transaction, such as third-party litigation, a judicial order blocking the transaction or lack of shareholder approval, could also prevent us from completing an announced acquisition.

If the goodwill that we record in connection with a business acquisition becomes impaired, it could require charges to earnings, which would have a negative impact on our financial condition and results of operations.

Goodwill represents the amount by which the cost of an acquisition exceeded the fair value of net assets we acquired in connection with the purchase of another financial institution. We review goodwill for impairment at least annually, or more frequently if events or changes in circumstances indicate that the carrying value of the asset might be impaired.

We determine impairment by comparing the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Any such adjustments are reflected in our results of operations in the periods in which they become known. As of December 31, 2019, our goodwill totaled \$26.1 million, \$8.7 million of which was recognized in 2019 in connection with two acquisitions. While we have not recorded any such impairment charges since we initially recorded the goodwill, there can be no assurance that our future evaluations of goodwill will not result in findings of impairment and related write-downs, which may have a material adverse effect on our financial condition and results of operations.

Factors outside our control could result in impairment of or losses with respect to our investment securities.

Under applicable accounting standards, we are required to review our securities portfolio periodically for the presence of other-than-temporary impairment, taking into consideration current market conditions, the extent and nature of changes in fair value, issuer rating changes and trends, volatility of earnings, current analysts' evaluations, our ability and intent to hold securities until a recovery of fair value, as well as other factors. Adverse developments with respect to one or more of the foregoing factors may require us to deem particular securities to be other-than-temporarily impaired, with the credit related portion of the reduction in the value recognized as a charge to the results of operations in the period in which the impairment occurs. Market volatility may make it difficult to value certain securities. Subsequent valuations, in light of factors prevailing at that time, may result in significant changes in the values of these securities in future periods.

Any of these factors could require us to recognize further impairments in the value of our securities portfolio, which may have an adverse effect on our results of operations in future periods.

A lack of liquidity could adversely affect our ability to fund operations and meet our obligations as they become due.

Liquidity is essential to our business. Liquidity risk is the potential that we will be unable to meet our obligations as they come due because of an inability to liquidate assets or obtain adequate funding. The primary source of the Bank's funds are customer deposits and loan repayments, while borrowings are a secondary source of liquidity. Our access to deposits and other funding sources in adequate amounts and on acceptable terms is affected by a number of factors, including rates paid by competitors, returns available to customers on alternative investments and general economic conditions. Any decline in available funding could adversely impact our ability to originate loans, invest in securities, meet our expenses, pay dividends to our shareholders, or to fulfill obligations such as repaying our borrowings or meeting deposit withdrawal demands, any of which could have a material adverse impact on our business, financial condition, results of operations and growth prospects.

The Company may be materially and adversely affected by the creditworthiness and liquidity of other financial institutions.

Financial services institutions are interrelated as a result of trading, clearing, counterparty and other relationships. Our Bank has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks, and other institutional clients. Many of these transactions expose our Bank to credit risk in the event of a default by a counterparty or client. In addition, our Bank's credit risk may be increased when the collateral to which it is entitled cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of its credit or derivative exposure. Any such losses could have a material adverse effect on our business, financial condition, and results of operations.

We rely on information technology and telecommunications systems and third-party vendors, and our failure to effectively implement new technology or a disruption of service could adversely affect our operations and financial condition.

Our industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. We believe that improved technology allows us to serve our customers in a more efficient and less costly manner. Our ability to compete successfully to some extent depends on whether we can implement new technologies to provide products and services to our customers while avoiding significant operational challenges that increase our costs or delay full implementation of technology enhancements or new products, especially relative to our peers (many of which have greater resources to devote to technological improvements).

Although new technologies enable us to enhance the products and services we offer our customers, this technology exposes us to certain risks. First, the successful and uninterrupted functioning of our information technology and telecommunications systems is critical to our business. We outsource many of our major systems, such as data processing, loan servicing and deposit processing. If one of these third-party service providers terminates their relationship with us or fails to provide services to us for any reason or provides such services poorly, our business will be negatively affected. In addition, we may be forced to replace such vendor, which could interrupt our operations and result in a higher cost to us.

Cyber-attacks or other security breaches could adversely affect our operations, net income or reputation.

As part of our banking business, we collect, use and hold sensitive data concerning individuals and businesses with whom we have a banking relationship. Threats to data security, including unauthorized access and cyber-attacks, rapidly emerge and change, exposing us to additional costs for protection or remediation and competing time constraints to secure our data in accordance with customer expectations and statutory and regulatory requirements. The increasing sophistication of cyber-criminals makes it extremely difficult to keep up with new threats and could result in a breach of our data security. Patching and other measures to protect existing systems and servers could be inadequate, especially on systems that are being retired. Controls employed by our information technology department and third-party vendors could prove inadequate. We could also experience a breach by intentional or negligent conduct on the part of our employees or other internal sources or by merchants using our customers' debit and credit cards, software bugs or other technical malfunctions, or other causes. Cyber threats are rapidly evolving and we may not be able to anticipate or prevent all such attacks. As a result of any of these threats, our computer systems and/or our customer accounts could become vulnerable to misappropriation of confidential information, account takeover schemes or cyber-fraud. Our systems and those of our third-party vendors may become vulnerable to damage or disruption due to circumstances beyond our or their control, such as from catastrophic events, power anomalies or outages, natural disasters, network failures, and viruses and malware.

A breach of our security that results in unauthorized access to our data could result in violations of applicable privacy and other laws and expose us to a disruption or challenges relating to our daily operations as well as to data loss, litigation, damages, fines and penalties, customer notification requirements, significant increases in compliance and insurance costs, increases in costs for measures to minimize these risks, loss of confidence in our security measures, and reputational damage, any of which could individually or in the aggregate have a material adverse effect on our business, results of operations, financial condition, prospects, and shareholder value.

We have attempted to address these concerns by backing up our systems as well as retaining qualified third-party vendors to test and audit our network. However, there can be no guarantees that our efforts will be successful in avoiding material problems with our information technology and telecommunications systems. We may not be able to anticipate all cyber security breaches or implement effective preventative measures against such breaches.

We face significant operational and other risks related to our activities, which could expose us to negative publicity, litigation and/or regulatory action.

We are exposed to many types of operational risks, including business continuity, process, third party, information technology, human resource, model, and fraud risks. Our fraud risks include fraud committed by external parties against the Company or our customers and fraud committed internally by our associates. Certain fraud risks, including identity theft and account takeover may increase as a result of customers' account or personally identifiable information being obtained through breaches of retailers' or other third parties' networks. We have established processes and procedures intended to identify, measure, monitor, mitigate, report and analyze these risks; however, there are inherent limitations to our risk management strategies as there may exist, or develop in the future, risks that we have not appropriately anticipated, monitored or identified. If our risk management framework proves ineffective, we could suffer unexpected losses, we may have to expend resources detecting and correcting the failure in our systems and we may be subject to potential claims from third parties and government agencies. We may also suffer severe reputational damage. Any of these consequences could adversely affect our business, financial condition or results of operations. In particular, the unauthorized disclosure, misappropriation, mishandling or misuse of personal, non-public, confidential or proprietary information of customers could result in significant regulatory consequences, reputational damage and financial loss.

Because the nature of the financial services industry involves a high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. The Company's necessary dependence upon automated systems to record and process our transaction volume may further increase the risk that technical flaws or associate tampering or manipulation of those systems will result in losses that are difficult to detect. We also may be subject to disruptions of our operating systems arising from events that are wholly or partially beyond our control (for example, computer viruses or electrical or telecommunications outages), which may give rise to disruption of service to customers and to financial loss or liability. The Company is further exposed to the risk that our external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees we are) and to the risk that the Company (or our vendors') business continuity and data security systems prove to be inadequate.

Our success depends on our ability to respond to the threats and opportunities of fintech innovation.

Fintech developments, such as bitcoin or other types of cryptocurrency and the development of alternative payment systems, have the potential to disrupt the financial industry and change the way banks do business. Investment in new technology to stay competitive would result in significant costs and increased risks of cyber-attacks. Our success depends on our ability to adapt to the pace of the rapidly changing technological environment, which is crucial to retention and acquisition of customers. On July 31, 2018, the Office of the Comptroller of the Currency announced it will grant limited-purpose national bank charters to fintech companies that offer bank products and services. The federal charter would allow fintech companies to operate nationwide under a single set of national standards, without needing to seek state-by-state licenses or joining with brick-and-mortar banks, which could have the effect of allowing fintech companies to more easily compete with us for financial products and services in the communities we serve. In October 2019, a federal district court blocked the OCC's ability to issue such charters. The OCC has filed an appeal which is still pending.

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

A significant portion of our loan portfolio is secured by real property. Also, in the ordinary course of business, we may foreclose on and take title to properties securing certain loans or purchase real estate to expand our facilities. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property's value or limit our ability to use or sell the affected property. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our business, financial condition, results of operations and growth prospects. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although management has policies and procedures to perform an environmental review before the loan is recorded and before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards.

We may be subject to increased litigation which could result in legal liability and damage to our reputation.

The Company and the Bank have been named from time to time as defendants in litigation relating to our businesses and activities. Litigation may include claims for substantial compensatory or punitive damages or claims for indeterminate amounts of damages. We are also involved from time to time in other reviews, investigations and proceedings (both formal and informal) by governmental and self-regulatory agencies regarding our business. These matters also could result in adverse judgments, settlements, fines, penalties, injunctions or other relief.

In addition, in recent years, a number of judicial decisions have upheld the right of borrowers to sue lending institutions on the basis of various evolving legal theories, collectively termed "lender liability." Generally, lender liability is founded on the premise that a lender has either violated a duty, whether implied or contractual, of good faith and fair dealing owed to the borrower or has assumed a degree of control over the borrower resulting in the creation of a fiduciary duty owed to the borrower or its other creditors or shareholders. Substantial legal liability or significant regulatory action against us could materially adversely affect our business, financial condition or results of operations, or cause significant harm to our reputation.

Risks Related to Our Industry

We operate in a highly regulated environment, which could restrain our growth and profitability.

We are subject to extensive regulation and supervision under federal and state banking laws and regulations that govern almost all aspects of our operations, including, among other things, our lending practices, capital structure, investment practices, dividend policy, operations and growth. These laws and regulations, and the supervisory framework that oversees the administration of these laws and regulations, are primarily intended to protect consumers, depositors, the Deposit Insurance Fund and the banking system as a whole, and not shareholders and counterparties. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which was signed into law on July 21, 2010, significantly changed the bank regulatory structure and affected a wide range of areas of financial institutions and their holding companies. For example, it, among other things, (i) established the Bureau of Consumer Financial Protection which has broad rulemaking and enforcement authority over consumer financial products and services, (ii) increased the regulation of consumer protections regarding residential mortgage originations and servicing, and (iii) limited the interchange fees payable on debit card transactions. Furthermore, new proposals for legislation continue to be introduced in the U.S. Congress that could further substantially increase regulation of the financial services industry, impose restrictions on our operations and our ability to conduct business consistent with historical practices, including in the areas of compensation, interest rates, financial product offerings and disclosures, and have an effect on bankruptcy proceedings with respect to consumer residential real estate mortgages, among other things, which could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

Our efforts to comply with these additional laws, regulations and standards are likely to result in increased expenses and a diversion of management time and attention. The information under the heading “Supervision and Regulation” in *Item 1, Business*, provides more information regarding the regulatory environment in which we and the Bank operate.

Federal regulators periodically examine our business, and we may be required to remediate adverse examination findings.

The financial services industry is subject to intense scrutiny from bank supervisors in the examination process and aggressive enforcement of regulations on both the federal and state levels. The Federal Reserve, and the OCC, periodically examine our business, including our compliance with laws and regulations. If, as a result of an examination, a federal banking agency were to determine that our financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of any of our operations had become unsatisfactory, or that we were in violation of any law or regulation, it may take a number of different remedial actions as it deems appropriate. These actions include the power to enjoin “unsafe or unsound” practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in our capital, to restrict our growth, to assess civil monetary penalties against our officers or directors, to remove officers and directors and, if it is concluded that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate our deposit insurance and place us into receivership or conservatorship. If we become subject to any regulatory actions, it could have a material adverse effect on our business, results of operations, financial condition and growth prospects. Failure to comply with any applicable regulations and supervisory expectations related thereto could result in fines, penalties, lawsuits, regulatory sanctions, reputation damage or restrictions on business.

We may be required to pay significantly higher FDIC deposit insurance premiums in the future.

The deposits of Investar Bank are insured by the FDIC up to legal limits and, accordingly, subject it to the payment of FDIC deposit insurance assessments. We are generally unable to control the amount of premiums that we are required to pay for FDIC deposit insurance. A bank's regular assessments are determined by its risk classification, which is based on its regulatory capital levels and the level of supervisory concern that it poses. The most recent economic recession, insured depository institution failures, general deterioration in banking and economic conditions, and significantly increased losses of the FDIC resulted in a decline in the designated reserve ratio of the FDIC to historical lows. To restore this reserve ratio and bolster its funding position, the FDIC imposed a special assessment on depository institutions and also increased deposit insurance assessment rates. Further increases in assessment rates are possible in the future, especially if there are additional bank failures. Any increase in deposit insurance assessment rates, or any future special assessment, could materially and adversely affect our business, results of operations, financial condition and growth prospects.

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

The Community Reinvestment Act, or CRA, the ECOA, the Fair Housing Act and other fair lending laws and regulations impose nondiscriminatory lending requirements on financial institutions. The Department of Justice and other federal agencies enforce these laws and regulations, but private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. If an institution's performance under the Community Reinvestment Act or fair lending laws and regulations is found to be deficient, the institution could be subject to damages and civil money penalties, injunctive relief, restrictions on mergers and acquisitions activity, restrictions on expansion and restrictions on entering new business lines, among other sanctions. In addition, the OCC's assessment of our compliance with CRA provisions is taken into account when evaluating any application we submit for, among other things, approval of the acquisition or establishment of a branch or other deposit facility, an office relocation, a merger or the acquisition of another financial institution. Our failure to satisfy our CRA obligations could, at a minimum, result in the denial of such applications and limit our growth.

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

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

In addition, bank regulatory agencies consider the effectiveness of a financial institution's anti-money laundering activities and other regulatory compliance matters when reviewing bank mergers and bank holding company acquisitions. Accordingly, non-compliance with the applicable regulations could materially impair the Company's ability to enter into or complete mergers and acquisitions.

Our use of third-party vendors and our other ongoing third-party business relationships are subject to increasing regulatory requirements and attention.

We regularly use third-party vendors as part of our business. We also have substantial ongoing business relationships with other third parties. These types of third-party relationships are subject to increasingly demanding regulatory requirements and attention by our federal bank regulators. Regulation requires us to perform due diligence and ongoing monitoring and control over our third-party vendors and other ongoing third-party business relationships. In certain cases we may be required to renegotiate our agreements with these vendors to meet these requirements, which could increase our costs. We expect that our regulators will hold us responsible for deficiencies in our oversight and control of our third party relationships and in the performance of the parties with which we have these relationships. As a result, if our regulators conclude that we have not exercised adequate oversight and control over our third-party vendors or other ongoing third party business relationships or that such third parties have not performed appropriately, we could be subject to enforcement actions, including civil money penalties or other administrative or judicial penalties or fines as well as requirements for customer remediation, any of which could have a material adverse effect our business, financial condition or results of operations.

Risks Related to an Investment in our Common Stock

The market price of our common stock may be volatile, which may make it difficult for investors to sell their shares at the volume, prices and times desired.

The market price of our common stock may fluctuate substantially due to a variety of factors, many of which are beyond our control, including, without limitation:

- actual or anticipated variations in our quarterly and annual operating results, financial condition or asset quality;
- changes in general economic or business conditions, both domestically and internationally;
- the effects of, and changes in, trade, monetary and fiscal policies, including the interest rate policies of the Federal Reserve, or in laws and regulations affecting us;
- changes in the credit, mortgage and real estate markets
- the number of securities analysts covering us;
- our creditworthiness;
- publication of research reports about us, our competitors, or the financial services industry generally, or changes in, or failure to meet, securities analysts' estimates of our financial and operating performance, or lack of research reports by industry analysts or ceasing of coverage;
- changes in market valuations or earnings of companies that investors deemed comparable to us;
- the average daily trading volume of our common stock;
- future issuances of our common stock or other securities;
- changes in dividends on our common stock;
- additions or departures of key personnel;
- perceptions in the marketplace regarding our competitors and/or us;
- significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving our competitors or us; and
- other news, announcements or disclosures (whether by us or others) related to us, our competitors, our core market or the financial services industry.

The stock market and, in particular, the market for financial institution stocks have experienced significant fluctuations in recent years. In many cases, these changes have been unrelated to the operating performance and prospects of particular companies. In addition, significant fluctuations in the trading volume in our common stock may cause significant price variations to occur. Increased market volatility may materially and adversely affect the market price of our common stock, which may make it difficult for investors to sell their shares at the volume, prices and times desired.

Shares eligible for future sale could adversely affect market prices of our common stock.

Shares of our common stock eligible for future sale, including those that may be issued in any private or public offering of our common stock, as consideration in acquisition transactions, or as incentives under incentive plans, could adversely affect market prices for our common stock. As of December 31, 2019, we had 11,228,775 shares outstanding and 357,214 shares subject to options granted under our incentive plan. On December 19, 2019, we sold 1,290,323 shares of our common stock in a private placement and have registered those shares for resale under the Securities Act of 1933, as amended (the “Securities Act”). Because our other outstanding shares of common stock either were issued in an offering registered under the Securities Act or have been held for more than one year, such shares are freely tradable, except for shares held by our affiliates (approximately 8% of shares outstanding as of December 31, 2019) and 168,216 shares that represent unvested restricted shares under our incentive plan. Shares issued under our incentive plan will be available for sale into the public market, except for shares held by our affiliates. Shares held by our affiliates may be resold subject to the restrictions in Rule 144 of the Securities Act. In the future, we may issue additional shares of common stock to raise capital for growth or as consideration in acquisition transactions or for other purposes, and such shares may be registered under the Securities Act and freely tradable or may be issued in a private placement and registered for resale under the Securities Act.

Our dividend policy may change without notice, and our future ability to pay dividends is subject to restrictions.

Holders of our common stock are entitled to receive only such cash dividends as our board of directors may declare out of funds legally available for the payment of dividends. We have no obligation to continue paying dividends, and we may change our dividend policy at any time without notice to our shareholders. In addition, our existing and future debt agreements limit, or may limit, our ability to pay dividends. Under the terms of our 5.125% Fixed-to-Floating Rate Subordinated Notes due 2020, we may not pay a dividend if either our parent company or the Bank, both immediately prior to the declaration of the dividend and after giving effect to the payment of the dividend, would not maintain regulatory capital ratios that are as “well capitalized” levels for regulatory capital purposes. We are also prohibited from paying dividends upon and during the continuance of any Event of Default under such notes.

Since the Company’s primary asset is its stock of Investar Bank, we are dependent upon dividends from the Bank to pay our operating expenses, satisfy our obligations and to pay dividends on the Company’s common stock. Accordingly, any declaration and payment of dividends on common stock will substantially depend upon the Bank’s earnings and financial condition, liquidity and capital requirements, the general economic and regulatory climate and other factors deemed relevant by our board of directors. Furthermore, consistent with our strategic plans, growth initiatives, capital availability, projected liquidity needs, and other factors, we have made, and will continue to make, capital management decisions and policies that could adversely impact the amount of dividends, if any, paid to our common shareholders.

In addition, there are numerous laws and banking regulations that limit our and Investar Bank’s ability to pay dividends. For Investar Bank, federal statutes and regulations require, among other things, that the Bank maintain certain levels of capital in order to pay a dividend. Further, federal banking authorities have the ability to restrict the payment of dividends by supervisory action. At the holding company level, the Federal Reserve Board has indicated that bank holding companies should carefully review their dividend policy in relation to the organization’s overall asset quality, level of current and prospective earnings and level, composition and quality of capital. The guidance requires that a company inform and consult with the Federal Reserve Board prior to declaring and paying a dividend that exceeds earnings for the period for which the dividend is being paid or that could result in an adverse change to its capital structure.

Our Restated Articles of Incorporation and By-laws, and certain banking laws applicable to us, could have an anti-takeover effect that decreases our chances of being acquired, even if our acquisition is in our shareholders’ best interests.

Certain provisions of our restated articles of incorporation and our by-laws, as amended, and federal banking laws, including regulatory approval requirements, could make it more difficult for a third party to acquire control of our organization or conduct a proxy contest, even if those events were perceived by many of our shareholders as beneficial to their interests. These provisions, and the corporate and banking laws and regulations applicable to us:

- enable our board of directors to issue additional shares of authorized, but unissued capital stock. In particular, our board may issue “blank check” preferred stock with such designations, rights and preferences as may be determined from time to time by the board;
- enable our board of directors to increase the size of the board and fill the vacancies created by the increase;
- enable our board of directors to amend our by-laws without shareholder approval;
- require advance notice for director nominations and other shareholder proposals; and

- require prior regulatory application and approval of any transaction involving control of our organization.

These provisions may discourage potential acquisition proposals and could delay or prevent a change in control, including circumstances in which our shareholders might otherwise receive a premium over the market price of our shares.

Our issuance of preferred stock could adversely affect holders of our common stock and discourage a takeover.

Our shareholders authorized our board of directors to issue up to 5,000,000 shares of preferred stock without any further action on the part of our shareholders. The board also has the power, without shareholder approval, to set the terms of any series of preferred stock that may be issued, including voting rights, dividend rights, preferences over our common stock with respect to dividends or in the event of a dissolution, liquidation or winding up and other terms. In the event that we issue preferred stock in the future that has preference over our common stock with respect to payment of dividends or upon our liquidation, dissolution or winding up, or if we issue preferred stock with voting rights that dilute the voting power of our common stock, the rights of the holders of our common stock or the market price of our common stock could be adversely affected. In addition, the ability of our board of directors to issue shares of preferred stock without any action on the part of our shareholders may impede a takeover of us and prevent a transaction perceived to be favorable to our shareholders.

An investment in our common stock is not an insured deposit and is subject to risk of loss.

Our common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any deposit insurance fund or by any other public or private entity. Investment in our common stock is inherently risky for the reasons described in this “Risk Factors” section and elsewhere in this Annual Report on Form 10-K and is subject to the same market forces that affect the price of common stock in any company. As a result, an investor may lose some or all of his or her investment in our common stock.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

Our main office, which serves as our executive and operations center, is located at 10500 Coursey Boulevard in Baton Rouge, Louisiana. In addition, we operate 30 branch offices located in Ascension (2), East Baton Rouge (6), Jefferson (2), Lafayette (2), Livingston (1), St. Tammany (1), Tangipahoa (1) West Baton Rouge (1), East Feliciana (2), West Feliciana (1), Evangeline (3) and Calcasieu (1) Parishes, Louisiana, three branch offices located in Galveston (2) and Houston (1) Counties, Texas, two branch offices located in Sumter County, Alabama and, as of February 21, 2020, two branch offices located in Victoria (1) and Jim Wells (1) Counties, Texas. We also have a stand-alone automated teller machine in Baton Rouge, Louisiana and one stand-alone interactive teller machine in Lake Charles, Louisiana.

We own our main office and all of our branch offices in Louisiana and Alabama, with the exception of one leased branch location, opened in October 2019. Each of our owned branch facilities is a stand-alone building, equipped with an automated teller machine, on-site parking, and drive-up access. Of the branches acquired from Mainland, located in Texas, one location is owned and two are leased properties. Both branches acquired from PlainsCapital, also located in Texas, are leased properties. We believe that our facilities are in good condition and are adequate to meet our operating needs for the foreseeable future.

We also own two tracts of land in East Baton Rouge Parish and a tract of land in each of the following parishes: St. Mary Parish; Lafayette Parish; Jefferson Parish; and Calcasieu Parish. Each tract of land has been designated as a future branch location. The tract of land in Calcasieu Parish is currently being developed and will operate as a full-service branch location in 2020. The timing of the development of the remaining tracts of land is uncertain. In addition, we lease a building in our New Orleans market that has been designated as a future branch location.

Item 3. Legal Proceedings

From time to time we are party to ordinary routine litigation matters incidental to the conduct of our business. We are not presently party to, and none of our property is the subject of, any legal proceedings, the resolution of which we believe would have a material adverse effect on our business, financial condition, results of operations, cash flows, growth prospects or capital levels, nor were any such proceedings terminated during the fourth quarter of 2019.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information

Our common stock is listed on the Nasdaq Global Market (the "Nasdaq") under the symbol "ISTR." As of March 11, 2020, there were approximately 750 holders of record of our common stock.

Dividend Policy

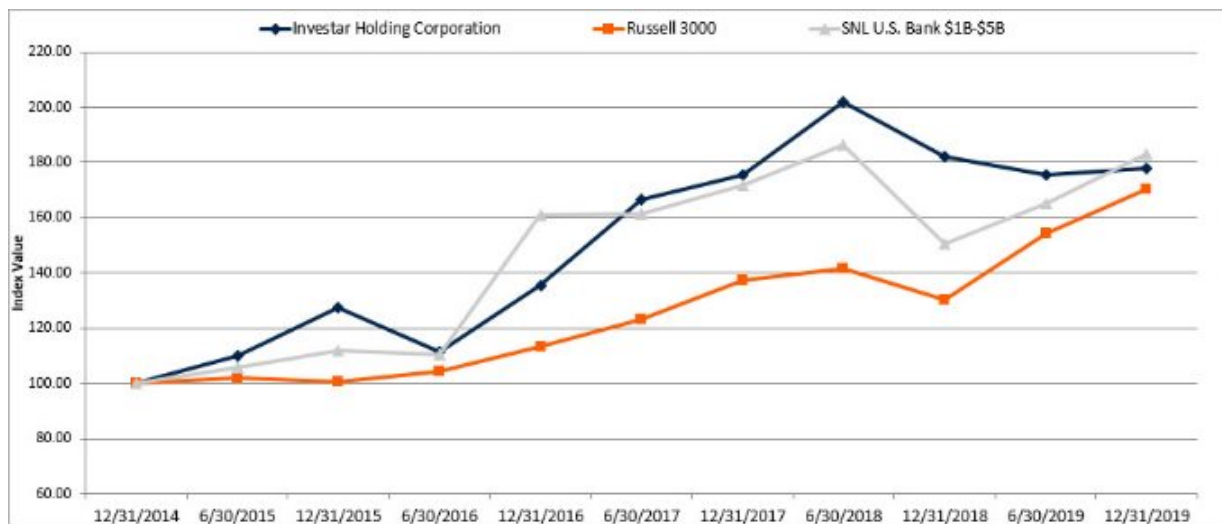
The Company has paid a quarterly dividend since 2011 and intends to continue to declare dividends on a quarterly basis. The declaration of dividends is at the discretion of our board of directors and will depend on our financial performance, future prospects, regulatory requirements and other factors deemed relevant by the board of directors.

Since we are a holding company with no material business activities, our ability to pay dividends is substantially dependent upon the ability of Investar Bank to transfer funds to us in the form of dividends, loans and advances. The Bank's ability to pay dividends and make other distributions and payments to us depends upon the Bank's earnings, financial condition, general economic conditions, compliance with regulatory requirements and other factors. In addition, the Bank's ability to pay dividends to us is itself subject to various legal, regulatory and other restrictions. See "Supervision and Regulation—Dividends" in *Item 1, Business*, above for a discussion of the restrictions on dividends under federal banking laws and regulations. In addition, as a Louisiana corporation, we are subject to certain restrictions on dividends under the Louisiana Business Corporation Act. Generally, a Louisiana corporation may pay dividends to its shareholders unless, after giving effect to the dividend, either (1) the corporation would not be able to pay its debts as they come due in the usual course of business or (2) the corporation's total assets are less than the sum of its total liabilities and the amount that would be needed, if the corporation were to be dissolved at the time of the payment of the dividend, to satisfy the preferential rights of shareholders whose preferential rights are superior to those receiving the dividend. In addition, our existing and future debt agreements limit, or may limit, our ability to pay dividends. Under the terms of our 5.125% Fixed-to-Floating Rate Subordinated Notes due 2029, we may not pay a dividend if either our parent company or the Bank, both immediately prior to the declaration of the dividend and after giving effect to the payment of the dividend, would not maintain regulatory capital ratios that are at "well capitalized" levels for regulatory capital purposes. We are also prohibited from paying dividends upon and during the continuance of any Event of Default under such notes. Finally, our ability to pay dividends may be limited on account of the junior subordinated debentures that we assumed through acquisitions. We must make payments on the junior subordinated debentures before any dividends can be paid on our common stock.

These restrictions do not, and are not expected in the future to, materially limit the Company's ability to pay dividends to its shareholders in an amount consistent with the Company's history of paying dividends.

Stock Performance Graph

The following graph compares the cumulative total shareholder return on the Company's common stock over a measurement period beginning January 1, 2015 with (i) the cumulative total return on the stocks included in the Russell 3000 Index and (ii) the cumulative total return on the stocks included in the SNL Index of Banks with assets between \$1 billion and \$5 billion. The performance graph assumes that the value of the investment in our common stock, the Russell 3000 Index and the SNL Index of Banks was \$100 at January 1, 2015, the date our common stock began publicly trading on the Nasdaq, and that all dividends were reinvested.



Index	12/31/2014	6/30/2015	12/31/2015	6/30/2016
Investar Holding Corporation	\$ 100.00	\$ 109.85	\$ 127.33	\$ 111.41
Russell 3000	100.00	101.94	100.48	104.12
SNL U.S. Bank \$1B-\$5B	100.00	105.82	111.94	110.49
Index	12/31/2016	6/30/2017	12/31/2017	6/30/2018
Investar Holding Corporation	\$ 135.28	\$ 166.41	\$ 175.35	\$ 201.73
Russell 3000	113.27	123.39	137.21	141.63
SNL U.S. Bank \$1B-\$5B	161.04	161.37	171.69	186.49
Index	12/31/2018	6/30/2019	12/31/2019	
Investar Holding Corporation	\$ 181.86	\$ 175.30	\$ 177.70	
Russell 3000	130.02	154.35	170.35	
SNL U.S. Bank \$1B-\$5B	150.42	165.05	182.85	

There can be no assurance that our common stock performance will continue in the future with the same or similar trends depicted in the performance graph above. We will not make or endorse any predictions as to future stock performance.

The information provided under the heading "Stock Performance Graph" shall not be deemed to be "soliciting material" or to be "filed" with the SEC or subject to its proxy regulations or to the liabilities of Section 18 of the Securities Exchange Act of 1934, as amended, other than as provided in Item 201 of Regulation S-K. The information provided in this section shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.

Issuer Purchases of Equity Securities

Period	(a) Total Number of Shares (or Units) Purchased ⁽¹⁾	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) That May Be Purchased Under the Plans or Programs ⁽²⁾
October 1, 2019 to October 31, 2019	127	\$ 23.70	—	326,334
November 1, 2019 to November 30, 2019	—	—	—	326,334
December 1, 2019 to December 31, 2019	—	—	—	326,334
	127	\$ 23.70	—	326,334

⁽¹⁾ Shares surrendered to cover the payroll taxes due upon the vesting of restricted stock.

⁽²⁾ On February 5, 2019, the Company announced that its board of directors authorized the repurchase of an additional 300,000 shares of the Company's common stock under its stock repurchase plan, in addition to the 86,240 shares that were remaining as authorized for repurchase at December 31, 2018. On June 26, 2019, the Company announced that its board of directors authorized the repurchase of an additional 300,000 shares of the Company's common stock.

Unregistered Sales of Equity Securities

Information regarding the Company's unregistered sales of equity securities during the period covered by this report has been previously included in the Current Report on Form 8-K.

Securities Authorized for Issuance under Equity Compensation Plans

Please refer to the information under the heading "Securities Authorized for Issuance under Equity Compensation Plans" in *Item 12, Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*, for a discussion of the securities authorized for issuance under the Company's equity compensation plans.

Item 6. Selected Financial Data

The following table sets forth selected historical financial information and other data as of and for the years ended December 31, 2019, 2018, 2017, 2016, and 2015. The selected financial data is derived from our audited historical consolidated financial statements. The information below should be read in conjunction with other information contained in this report, including the information contained in *Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations*, and the consolidated financial statements and related notes in *Item 8, Financial Statements and Supplementary Data*. Our historical results for any prior period are not necessarily indicative of results to be expected in any future period.

(In thousands, except share data)

	As of December 31,				
	2019 ⁽¹⁾	2018	2017 ⁽¹⁾	2016	2015
Financial Condition Data					
Total assets	\$ 2,148,916	\$ 1,786,469	\$ 1,622,734	\$ 1,158,960	\$ 1,031,555
Total gross loans, net of allowance for loan losses	1,681,275	1,391,371	1,250,888	886,375	819,822
Allowance for loan losses	10,700	9,454	7,891	7,051	6,128
Investment securities	274,214	265,047	235,561	183,142	139,779
Goodwill and other intangible assets	31,035	19,787	19,926	3,234	3,175
Noninterest-bearing deposits	351,905	217,457	216,599	108,404	90,447
Interest-bearing deposits	1,355,801	1,144,274	1,008,638	799,383	646,959
Total deposits	1,707,706	1,361,731	1,225,237	907,787	737,406
Total borrowings	183,318	232,549	212,553	126,499	170,205
Long-term borrowings	127,223	27,150	64,018	12,809	11,969
Total stockholders' equity	241,976	182,262	172,729	112,757	109,350
As of and for the year ended December 31,					
	2019 ⁽¹⁾	2018	2017 ⁽¹⁾	2016	2015
Income Statement Data					
Interest income	\$ 89,443	\$ 73,891	\$ 53,346	\$ 43,152	\$ 37,340
Interest expense	24,625	16,521	10,829	8,413	5,882
Net interest income	64,818	57,370	42,517	34,739	31,458
Provision for loan losses	1,908	2,570	1,540	2,079	1,865
Net interest income after provision	62,910	54,800	40,977	32,660	29,593
Noninterest income	6,216	4,318	3,815	5,468	8,344
Noninterest expense	48,168	41,882	32,342	26,639	27,353
Income before income taxes	20,958	17,236	12,450	11,489	10,584
Income tax expense	4,119	3,630	4,248	3,609	3,511
Net income	16,839	13,606	8,202	7,880	7,073

As of and for the year ended December 31,

	2019 ⁽¹⁾	2018	2017 ⁽¹⁾	2016	2015
Per Common Share Data					
Basic earnings per share	\$ 1.68	\$ 1.41	\$ 0.96	\$ 1.11	\$ 0.98
Diluted earnings per share	1.66	1.39	0.96	1.10	0.97
Dividends per share	0.23	0.17	0.10	0.04	0.03
Book value per share	21.55	19.22	18.15	15.88	15.05
Tangible book value per share ⁽²⁾	18.79	17.13	16.06	15.42	14.62
Period end common shares outstanding	11,228,775	9,484,219	9,514,926	7,101,851	7,264,282
Basic weighted average common shares outstanding	9,931,497	9,538,891	8,399,584	7,107,187	7,214,045
Diluted weighted average common shares outstanding	10,031,018	9,664,843	8,456,928	7,149,834	7,258,008
Performance Ratios					
Return on average assets	0.85%	0.81%	0.62%	0.71%	0.77%
Return on average equity	8.21	7.68	5.65	6.99	6.60
Net interest margin	3.51	3.61	3.39	3.32	3.61
Efficiency ratio ⁽³⁾	67.81	67.89	69.80	66.25	68.72
Net interest income to average assets	3.28	3.40	3.19	3.14	3.42
Dividend payout ratio	13.55	12.09	10.78	3.80	3.26
Asset Quality Ratios					
Nonperforming assets to total assets	0.30%	0.54%	0.46%	0.52%	0.30%
Nonperforming loans to total loans	0.37	0.42	0.29	0.22	0.32
Allowance for loan losses to total loans	0.63	0.67	0.63	0.79	0.82
Allowance for loan losses to nonperforming loans	171.09	158.94	214.43	356.16	254.16
Net charge-offs to average loans	0.04	0.08	0.07	0.14	0.05
Capital Ratios					
Total equity to total assets	11.26%	10.20%	10.64%	9.73%	10.60%
Tangible equity to tangible assets ⁽⁴⁾	9.96	9.20	9.53	9.48	10.32
Tier 1 capital to average assets	10.45	9.81	10.66	10.10	11.39
Common equity tier 1 capital ratio	11.67	11.15	11.75	11.4	0.1167
Tier 1 capital to risk-weighted assets	12.03	11.59	12.24	11.75	12.05
Total capital to risk-weighted assets	15.02	13.46	14.22	12.47	12.72

⁽¹⁾ Selected consolidated financial data includes the effect of mergers from the date of each merger. On July 1, 2017, the Company acquired Citizens Bancshares, Inc. and its wholly-owned subsidiary, Citizens Bank, by merger with and into the Company and Bank, respectively. On December 1, 2017, the Company acquired BOJ Bancshares, Inc. and its wholly-owned subsidiary, The Highlands Bank, by merger with and into the Company and Bank, respectively. On March 1, 2019, the Company acquired Mainland Bank, by merger with and into the Bank. On November 1, 2019, the Company acquired Bank of York, by merger with and into the Bank. References in this document to assets purchased and liabilities assumed in acquisition transactions reflect the fair value of such assets and liabilities on the date of acquisition, unless the context indicates otherwise.

⁽²⁾ Tangible book value per common share is a non-GAAP financial measure. Tangible book value per common share is calculated as total stockholders' equity less goodwill and other intangible assets, divided by the number of common shares outstanding as of the balance sheet date. We believe that the most directly comparable GAAP financial measure is book value per share. For more information regarding our use of non-GAAP financial measures, including a reconciliation of tangible book value per common share to book value per share, please refer to the information under the heading "Non-GAAP Financial Measures" in *Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations*.

⁽³⁾ Efficiency ratio represents noninterest expenses divided by the sum of net interest income (before provision for loan losses) and noninterest income. For more information regarding our use of non-GAAP financial measures, including our calculation of the efficiency ratio, please refer to the information under the heading "Non-GAAP Financial Measures" in *Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations*.

⁽⁴⁾ Tangible equity to tangible assets is a non-GAAP financial measure. Tangible equity is calculated as total stockholders' equity less goodwill and other intangible assets, and tangible assets is calculated as total assets less goodwill and other intangible assets. We believe that the most directly comparable GAAP financial measure is total equity to total assets. For more information regarding our use of non-GAAP financial measures, including a reconciliation of the ratio of tangible equity to tangible assets to the ratio of total equity to total assets, please refer to the information under the heading "Non-GAAP Financial Measures" in *Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations*.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This section presents management's perspective on the financial condition and results of operations of Investar Holding Corporation (the "Company," "we," "our," or "us") and its wholly-owned subsidiary, Investar Bank, National Association (the "Bank"). The following discussion and analysis should be read in conjunction with the Company's consolidated financial statements and related notes and other supplemental information included herein. Certain risks, uncertainties and other factors, including those set forth under *Item 1A, Risk Factors* in Part I, and elsewhere in this Annual Report on Form 10-K, may cause actual results to differ materially from those projected results discussed in the forward-looking statement appearing in this discussion and analysis.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This annual report on Form 10-K, both in Management's Discussion and Analysis of Financial Condition and Results of Operations, and elsewhere, contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These forward-looking statements include statements relating to our projected growth, anticipated future financial performance, financial condition, credit quality and performance goals, as well as statements relating to the anticipated effects on our business, financial condition and results of operations from expected developments, our growth, and potential acquisitions. These statements can typically be identified through the use of words or phrases such as "may," "should," "could," "predict," "potential," "believe," "think," "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.

Our forward-looking statements contained herein are based on assumptions and estimates that management believes to be reasonable in light of the information available at this time. However, many of these statements are inherently uncertain and beyond our control and could be affected by many factors. Factors that could have a material effect on our business, financial condition, results of operations, cash flows and future growth prospects can be found in *Item 1A, Risk Factors*. These factors include, but are not limited to, the following, any one or more of which could materially affect the outcome of future events:

- business and economic conditions generally and in the financial services industry in particular, whether nationally, regionally or in the markets in which we operate; including evolving risks to economic activity posed by the coronavirus;
- our ability to achieve organic loan and deposit growth, and the composition of that growth;
- changes (or the lack of changes) in interest rates, yield curves and interest rate spread relationships that affect our loan and deposit pricing;
- possible cessation or market replacement of LIBOR and the related effect on our LIBOR-based financial products and contracts, including, but not limited to, hedging products, debt obligations, investments, and loans;
- the extent of continuing client demand for the high level of personalized service that is a key element of our banking approach as well as our ability to execute our strategy generally;
- our dependence on our management team and our ability to attract and retain qualified personnel;
- changes in the quality or composition of our loan or investment portfolios, including adverse developments in borrower industries or in the repayment ability of individual borrowers;
- inaccuracy of the assumptions and estimates we make in establishing our allowance for loan losses and other estimates;
- the concentration of our business within our geographic areas of operation in Louisiana, Texas and Alabama;
- concentration of credit exposure;
- any deterioration in asset quality and higher loan charge-offs, and the time and effort necessary to resolve problem assets;
- a reduction in liquidity, including as a result of a reduction in the amount of deposits we hold or other sources of liquidity;
- our potential growth, including our entrance or expansion into new markets, and the need for sufficient capital to support that growth;
- difficulties in identifying attractive acquisition opportunities and strategic partners that will complement our relationship banking approach;
- our ability to complete any pending acquisitions and efficiently integrate completed acquisitions into our operations, meet the regulatory requirements related to such acquisitions, retain the customers of acquired businesses and grow the acquired operations;
- the impact of litigation and other legal proceedings to which we become subject;

- data processing system failures and errors;
- cyber attacks and other security breaches;
- competitive pressures in the commercial finance, retail banking, mortgage lending and consumer finance industries, as well as the financial resources of, and products offered by, competitors;
- the impact of changes in laws and regulations applicable to us, including banking, securities and tax laws and regulations and accounting standards, as well as changes in the interpretation of such laws and regulations by our regulators;
- changes in the scope and costs of FDIC insurance and other coverages;
- governmental monetary and fiscal policies;
- hurricanes, floods, other natural disasters and adverse weather; oil spills and other man-made disasters; acts of terrorism, an outbreak of hostilities or other international or domestic calamities, acts of God and other matters beyond our control; and
- other circumstances, many of which are beyond our control.

The foregoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included herein. If one or more events related to these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may differ materially from what we anticipate. Accordingly, you should not place undue reliance on any such forward-looking statements.

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

Overview

Through our wholly-owned subsidiary Investar Bank, National Association, we provide full banking services, excluding trust services, tailored primarily to meet the needs of individuals and small to medium-sized businesses. Our primary areas of operation are south Louisiana (approximately 86% of our total deposits as of December 31, 2019), including Baton Rouge, New Orleans, Lafayette and their surrounding areas; as of March 1, 2019, southeast Texas, including Houston and its surrounding area; and as of November 2019, west Alabama, including York and its surrounding area. Our Bank commenced operations in 2006 and we completed our initial public offering in July 2014. Our strategy includes organic growth through high quality loans and growth through acquisitions, including whole-bank acquisitions and strategic branch acquisitions. We currently operate 30 full service branches, including three branches from our acquisition of Mainland Bank on March 1, 2019 (in Texas City, Houston and Dickinson, Texas), two branches from our acquisition of Bank of York on November 1, 2019 (in York and Livingston, Alabama) and two branches acquired in February 2020 from PlainsCapital Bank (in Alice and Victoria, Texas). We have completed six whole-bank acquisitions since 2011 and regularly review acquisition opportunities. In addition to our branches acquired through acquisitions, during our last three fiscal years, we opened five de novo branch locations.

Our principal business is lending to and accepting deposits from individuals and small to medium-sized businesses in our areas of operation. We generate our income principally from interest on loans and, to a lesser extent, our securities investments, as well as from fees charged in connection with our various loan and deposit services and gains on the sale of securities. Our principal expenses are interest expense on interest-bearing customer deposits and borrowings, salaries, employee benefits, occupancy costs, data processing and operating expenses. We measure our performance through our net interest margin, return on average assets, and return on average equity, among other metrics, while seeking to maintain appropriate regulatory leverage and risk-based capital ratios.

Non-GAAP Financial Measures

Our accounting and reporting policies conform to accounting principles generally accepted in the United States, or GAAP, and the prevailing practices in the banking industry. However, we also evaluate our performance based on certain additional metrics. The efficiency ratio, tangible book value per share, and the ratio of tangible equity to tangible assets are not financial measures recognized under GAAP and, therefore, are considered non-GAAP financial measures.

Our management, banking regulators, financial analysts and investors use these non-GAAP financial measures to compare the capital adequacy of banking organizations with significant amounts of preferred equity and/or goodwill or other intangible assets, which typically stem from the use of the purchase accounting method of accounting for mergers and acquisitions. Tangible equity, tangible assets, tangible book value per share or related measures should not be considered in isolation or as a substitute for total stockholders' equity, total assets, book value per share or any other measure calculated in accordance with GAAP. Moreover, the manner in which we calculate tangible equity, tangible assets, tangible book value per share and any other related measures may differ from that of other companies reporting measures with similar names. The following table reconciles, as of the dates set forth below, stockholders' equity (on a GAAP basis) to tangible equity and total assets (on a GAAP basis) to tangible assets and calculates both our tangible book value per share and efficiency ratio (dollars in thousands).

	As of and for the year ended December 31,				
	2019	2018	2017	2016	2015
Total stockholders' equity - GAAP	\$ 241,976	\$ 182,262	\$ 172,729	\$ 112,757	\$ 109,350
Adjustments:					
Goodwill	26,132	17,424	17,086	2,684	2,684
Core deposit intangible	4,803	2,263	2,740	450	491
Trademark intangible	100	100	100	100	—
Tangible equity	\$ 210,941	\$ 162,475	\$ 152,803	\$ 109,523	\$ 106,175
Total assets - GAAP	\$ 2,148,916	\$ 1,786,469	\$ 1,622,734	\$ 1,158,960	\$ 1,031,555
Adjustments:					
Goodwill	26,132	17,424	17,086	2,684	2,684
Core deposit intangible	4,803	2,263	2,740	450	491
Trademark intangible	100	100	100	100	—
Tangible assets	\$ 2,117,881	\$ 1,766,682	\$ 1,602,808	\$ 1,155,726	\$ 1,028,380
Total shares outstanding	11,228,775	9,484,219	9,514,926	7,101,851	7,264,282
Book value per share	\$ 21.55	\$ 19.22	\$ 18.15	\$ 15.88	\$ 15.05
Effect of adjustment	(2.76)	(2.09)	(2.09)	(0.46)	(0.43)
Tangible book value per share	\$ 18.79	\$ 17.13	\$ 16.06	\$ 15.42	\$ 14.62
Total equity to total assets	11.26 %	10.20 %	10.64 %	9.73%	10.60%
Effect of adjustment	(1.30)	(1.00)	(1.11)	(0.25)	(0.28)
Tangible equity to tangible assets	9.96 %	9.20 %	9.53 %	9.48%	10.32%
Efficiency ratio⁽¹⁾					
Noninterest expense	\$ 48,168	\$ 41,882	\$ 32,342	\$ 26,639	\$ 27,353
Net interest income	64,818	57,370	42,517	34,739	31,458
Noninterest income	6,216	4,318	3,815	5,468	8,344
Efficiency ratio	67.81 %	67.89 %	69.80 %	66.25%	68.72%

⁽¹⁾ Calculated as noninterest expense divided by the sum of net interest income (before provision for loan losses) and noninterest income.

Critical Accounting Policies

The preparation of our consolidated financial statements in accordance with GAAP requires us to make estimates and judgments that affect our reported amounts of assets, liabilities, income and expenses and related disclosure of contingent assets and liabilities. Wherever feasible, we utilize third-party information to provide management with these estimates. Although independent third parties are engaged to assist us in the estimation process, management evaluates the results, challenges assumptions used and considers other factors which could impact these estimates. Actual results may differ from these estimates under different assumptions or conditions.

For more detailed information about our accounting policies, please refer to Note 1, Summary of Significant Accounting Policies, in the Notes to Consolidated Financial Statements contained in *Item 8, Financial Statements and Supplementary Data*. The following discussion presents an overview of some of our accounting policies and estimates that require us to make difficult, subjective or complex judgments about inherently uncertain matters when preparing our financial statements. We believe that the judgments, estimates and assumptions that we use in the preparation of our consolidated financial statements are appropriate.

Allowance for Loan Losses. One of the accounting policies most important to the presentation of our financial statements relates to the allowance for loan losses and the related provision for loan losses. The allowance for loan losses is established as losses are estimated through a provision for loan losses charged to earnings. The allowance for loan losses is based on the amount that management believes will be adequate to absorb probable losses inherent in the loan portfolio based on, among other things, evaluations of the collectability of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect borrowers' ability to pay. Another component of the allowance is losses on loans assessed as impaired under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 310, *Receivables* ("ASC 310"). The balance of the loans determined to be impaired under ASC 310 and the related allowance is included in management's estimation and analysis of the allowance for loan losses. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated cash flows.

The determination of the appropriate level of the allowance is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. We have an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in our portfolio and portfolio segments. We have an internally developed model that requires significant judgment to determine the estimation method that fits the credit risk characteristics of the loans in our portfolio and portfolio segments. Qualitative and environmental factors that may not be directly reflected in quantitative estimates include: asset quality trends, changes in loan concentrations, new products and process changes, changes and pressures from competition, changes in lending policies and underwriting practices, trends in the nature and volume of the loan portfolio, and national and regional economic trends. Changes in these factors are considered in determining changes in the allowance for loan losses. The impact of these factors on our qualitative assessment of the allowance for loan losses can change from period to period based on management's assessment of the extent to which these factors are already reflected in historic loss rates. The uncertainty inherent in the estimation process is also considered in evaluating the allowance for loan losses.

Acquisition Accounting. We account for our acquisitions under ASC Topic 805, *Business Combinations* ("ASC 805"), which requires the use of the purchase method of accounting. All identifiable assets acquired, including loans, are recorded at fair value (which is discussed below). The excess purchase price over the fair value of net assets acquired is recorded as goodwill. If the fair value of the net assets acquired exceeds the purchase price, a bargain purchase gain is recognized.

Because the fair value measurements incorporate assumptions regarding credit risk, no allowance for loan losses related to the acquired loans is recorded on the acquisition date. The fair value measurements of acquired loans are based on estimates related to expected prepayments and the amount and timing of undiscounted expected principal, interest and other cash flows. The fair value adjustment is amortized over the life of the loan using the effective interest method.

The Company accounts for acquired impaired loans under ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* ("ASC 310-30"). An acquired loan is considered impaired when there is evidence of credit deterioration since origination and it is probable at the date of acquisition that we will be unable to collect all contractually required payments. ASC 310-30 prohibits the carryover of an allowance for loan losses for acquired impaired loans. Over the life of the acquired loans, we continually estimate the cash flows expected to be collected on individual loans or on pools of loans sharing common risk characteristics. As of the end of each fiscal quarter, we evaluate the present value of the acquired loans using the effective interest rates. For any increases in cash flows expected to be collected, we adjust the amount of accretible yield recognized on a prospective basis over the loan's or pool's remaining life, while we recognize a provision for loan loss in the consolidated statement of operations if the cash flows expected to be collected have decreased.

Intangible Assets. Our intangible assets consist of goodwill, core deposit intangibles, and a trademark intangible. Goodwill represents the excess of the purchase price over the fair value of the net identifiable assets acquired in a business combination. Goodwill and other intangible assets deemed to have an indefinite useful life are not amortized but instead are subject to review for impairment annually, or more frequently if deemed necessary, in accordance with ASC Topic 350, *Intangibles – Goodwill and Other*. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives and reviewed for impairment in accordance with ASC Topic 360, *Property, Plant, and Equipment*. If impaired, the asset is written down to its estimated fair value. Core deposit intangibles representing the value of the acquired core deposit base are generally recorded in connection with business combinations involving banks and branch locations. Our policy is to amortize core deposit intangibles over the estimated useful life of the deposit base, either on a straight line basis not exceeding 15 years or an accelerated basis over 10 years. The remaining useful lives of core deposit intangibles are evaluated periodically to determine whether events and circumstances warrant revision of the remaining period of amortization.

Fair Value Measurement. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, using assumptions market participants would use when pricing an asset or liability. Fair value is best determined based upon quoted market prices. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows, and the fair value estimates may not be realized in an immediate settlement of the instruments. Accordingly, the aggregate fair value amounts presented do not necessarily represent our underlying value.

The definition of fair value focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

In accordance with fair value guidance, we group our financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

- *Level 1* – Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.
- *Level 2*—Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on 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 for substantially the full term of the asset or liability.
- *Level 3*—Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Other-Than-Temporary-Impairment on Investment Securities. On a quarterly basis, we evaluate our investment portfolio for other-than-temporary-impairment (“OTTI”) in accordance with ASC Topic 320, *Investments – Debt and Equity Securities*. An investment security is considered impaired if the fair value of the security is less than its cost or amortized cost basis. When impairment of an equity security is considered to be other-than-temporary, the security is written down to its fair value and an impairment loss is recorded in earnings. When impairment of a debt security is considered to be other-than-temporary, the security is written down to its fair value. The amount of OTTI recorded as a loss in earnings depends on whether we intend to sell the debt security and whether it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis. If we intend to sell the debt security or more likely than not will be required to sell the security before recovery of its amortized cost basis, the entire difference between the security’s amortized cost basis and its fair value is recorded as an impairment loss in earnings. If we do not intend to sell the debt security and it is not more likely than not that we will be required to sell the security before recovery of its amortized cost basis, OTTI is separated into the amount representing credit loss and the amount related to all other market factors. The amount related to credit loss is recognized in earnings. The amount related to other market factors is recognized in other comprehensive income, net of applicable taxes.

Stock-Based Compensation. We recognize compensation expense for all stock-based payments to employees in accordance with ASC Topic 718, *Compensation – Stock Compensation*. Under this accounting guidance, such payments are measured at fair value. Determining the fair value of, and ultimately the expense we recognize related to, our stock-based payments, particularly stock options, requires us to make assumptions regarding dividend yields, expected stock price volatility, and the expected life of the option. Changes in these assumptions and estimates can materially affect the calculated fair value of stock-based compensation and the related expense to be recognized.

Income Taxes. Accrued taxes represent the estimated amount payable to or receivable from taxing jurisdictions, either currently or in the future, and are reported in our consolidated statement of operations after exclusion of non-taxable income such as interest on state and municipal securities. Also, certain items of income and expenses are recognized in different time periods for financial statement purposes than for income tax purposes. Thus, provisions for deferred taxes are recorded in recognition of such temporary differences. The calculation of our income tax expense is complex and requires the use of many estimates and judgments in its determination.

Deferred taxes are determined utilizing a liability method whereby we recognize deferred tax assets for deductible temporary differences and deferred tax liabilities for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. We adjust deferred tax assets and liabilities for the effects of changes in tax laws and rates on the date of enactment.

The Company has adopted accounting guidance related to accounting for uncertainty in income taxes, which sets out a consistent framework to determine the appropriate level of tax reserves to maintain for uncertain tax positions. We recognize deferred tax assets if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term “more likely than not” means a likelihood of more than 50%. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management’s judgment. Deferred tax assets are reduced by a valuation allowance when, if based on the weight of evidence available, it is more likely than not that some portion or all of deferred tax asset will not be realized.

We recognize interest and penalties on income taxes as a component of income tax expense.

Overview of Financial Condition and Results of Operations

Net income for the year ended December 31, 2019 totaled \$16.8 million, or \$1.66 per diluted share, compared to \$13.6 million, or \$1.39 per diluted share, for the year ended December 31, 2018. This represents a \$3.2 million, or a 23.8%, increase in net income. The increase can mainly be attributed to the Company’s year-over-year interest-earning asset growth.

Key components of the Company’s performance during the year ended December 31, 2019 are summarized below.

- Total assets grew to \$2.1 billion at December 31, 2019, an increase of 20.3% from \$1.8 billion at December 31, 2018.
- Total loans, net of allowance for loan losses at December 31, 2019 were \$1.7 billion, an increase of \$289.9 million, or 20.8% compared to \$1.4 billion at December 31, 2018.

- Total deposits were \$1.7 billion at December 31, 2019, an increase of \$346.0 million, or 25.4%, compared to deposits of \$1.4 billion at December 31, 2018. Noninterest-bearing deposits increased \$134.4 million, or 61.8%, to \$351.9 million compared to \$217.5 million at December 31, 2018.
- Net interest income for the year ended December 31, 2019 was \$64.8 million, an increase of \$7.4 million, or 13.0%, compared to \$57.4 million for the year ended December 31, 2018. This increase was mainly driven by growth in interest-earning assets with an increase in interest income of \$15.6 million compared to the year ended December 31, 2018, with \$12.6 million due to an increase in volume and \$3.0 million due to an increase in rate. The increase in interest income was partially offset by an increase in interest-bearing liabilities resulting in an increase in interest expense of \$8.1 million compared to the year ended December 31, 2018, with \$2.0 million due to an increase in volume and \$6.1 million due to an increase in rate.
- The Bank completed two acquisitions during the year ended December 31, 2019. The acquisition of Mainland Bank in Texas City, Texas was completed on March 1, 2019, and the acquisition of Bank of York in York, Alabama was completed on November 1, 2019. See further discussion in *Acquisitions* below.
- The Bank opened two new branch locations during the fourth quarter of 2019. One branch is located in Lafayette, Louisiana, and the other branch is located in Westlake, Louisiana and is the Bank's first branch in the Lake Charles market area.
- The Company repurchased 359,906 shares of its common stock through its stock repurchase program at an average price of \$23.09 during the year ended December 31, 2019.

Certain Events That Affect Year-over-Year Comparability

Acquisitions. On March 1, 2019, the Company completed the acquisition of Mainland Bank ("Mainland"), a Texas state bank located in Texas City, Texas. The Company acquired 100% of Mainland's outstanding common shares for approximately \$18.6 million in the form of 763,849 shares of the Company's common stock. The acquisition of Mainland expanded the Company's branch footprint into Texas and increased the core deposit base to help position the Company to continue to grow. On the date of acquisition, Mainland had total assets with a fair value of approximately \$128.4 million, \$82.4 million in loans, and \$107.6 million in deposits, and served the residents of Harris and Galveston counties through three branch locations. The Company recorded a core deposit intangible and goodwill of \$2.4 million and \$4.5 million, respectively, related to the acquisition of Mainland.

On November 1, 2019, the Company completed the acquisition of Bank of York, an Alabama state bank located in York, Alabama. All of the issued and outstanding shares of Bank of York common stock were converted into aggregate cash merger consideration of \$15.0 million. On the date of acquisition, Bank of York had total assets with a fair value of \$102.0 million, \$46.1 million in loans, and \$85.0 million in deposits, and served the residents of Sumter County through two branch locations and one loan production office in Tuscaloosa County. The Company recorded a core deposit intangible and goodwill of \$0.9 million and \$4.2 million, respectively, related to the acquisition of Bank of York.

Debt and Equity Raise. During the fourth quarter of 2019, we completed both a subordinated debt issuance and a common stock offering. We issued and sold \$25.0 million in fixed-to-floating rate subordinated notes due in 2029. The common stock offering generated net proceeds of \$28.5 million through the issuance of 1.3 million common shares at a price of \$23.25 per share. The proceeds from the subordinated debt issuance and common stock offering were raised for general corporate purposes and potential strategic acquisitions.

Change in Tax Laws. On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was signed into law. The TCJA made broad and complex changes to the U.S. tax code that affected the Company's income tax rate in 2017 and 2018, including requiring the revaluation of the Company's deferred tax assets and liabilities as of December 31, 2017 as a result of the lower corporate tax rates to be realized beginning January 1, 2018. The TCJA reduced the U.S. federal corporate income tax rate from 35% to 21%.

Discussion and Analysis of Financial Condition

Total assets were \$2.1 billion at December 31, 2019, an increase of 20.3% from total assets of \$1.8 billion at December 31, 2018. Our total assets of \$1.8 billion at December 31, 2018 represents a 10.1% increase from total assets of \$1.6 billion at December 31, 2017. The growth experienced since December 31, 2017 can be attributed to organic growth of the Company through the hiring of a number of key bankers, including experienced commercial lenders, five de novo branch openings, as well as two acquisitions completed in 2019 which added assets with a fair value of \$230.4 million.

Loans

General. Loans constitute our most significant asset, comprising 79%, 78%, and 78% of our total assets at December 31, 2019, 2018 and 2017, respectively. Loans increased \$291.2 million, or 20.8%, to \$1.7 billion at December 31, 2019 from \$1.4 billion at December 31, 2018. Loans increased \$142.0 million, or 11.3%, to \$1.4 billion at December 31, 2018 from \$1.3 billion at December 31, 2017.

The table below sets forth the balance of loans, excluding loans held for sale, outstanding by loan type as of the dates presented, and the percentage of each loan type to total loans (dollars in thousands).

	December 31,									
	2019		2018		2017		2016		2015	
	Amount	Percentage of Total Loans	Amount	Percentage of Total Loans	Amount	Percentage of Total Loans	Amount	Percentage of Total Loans	Amount	Percentage of Total Loans
Mortgage loans on real estate:										
Construction and land development	\$ 197,797	11.7%	\$ 157,946	11.3%	\$ 157,667	12.5%	\$ 90,737	10.2%	\$ 81,863	11.0%
1-4 Family	321,489	19.0	287,137	20.5	276,922	22.0	177,205	19.8	156,300	21.0
Multifamily	60,617	3.6	50,501	3.6	51,283	4.1	42,759	4.8	29,694	4.0
Farmland	27,780	1.6	21,356	1.5	23,838	1.9	8,207	0.9	2,955	0.4
Commercial real estate										
Owner-occupied	352,324	20.8	298,222	21.3	272,433	21.6	180,458	20.2	137,752	18.5
Nonowner-occupied	378,736	22.4	328,782	23.5	264,931	21.0	200,258	22.4	150,831	20.2
Commercial and industrial	323,786	19.2	210,924	15.0	135,392	10.8	85,377	9.6	69,961	9.4
Consumer	29,446	1.7	45,957	3.3	76,313	6.1	108,425	12.1	116,085	15.5
Total loans	\$ 1,691,975	100%	\$ 1,400,825	100%	\$ 1,258,779	100%	\$ 893,426	100%	\$ 745,441	100%

Our focus on a relationship-driven banking strategy and the hiring of experienced commercial lenders are the primary reasons for our organic loan growth. Over the last three fiscal years, we have increased our focus on commercial real estate loans and commercial and industrial loans, including adding and expanding a new Commercial and Industrial division in early 2018. In addition, we completed two acquisitions in 2017 and two acquisitions in 2019.

The decrease in the consumer loan portfolio during this period is primarily a result of pay-downs of portfolio loans. At December 31, 2019, indirect auto loans made up 43.7% of the consumer loan portfolio. The Company discontinued accepting indirect auto loan applications on December 31, 2015 and expects its consumer loan portfolio as a percentage of the total loan portfolio to continue to decrease over time. At December 31, 2019, the weighted average remaining term of the indirect auto loan portfolio was 2.0 years.

At December 31, 2019, the Company's total business lending portfolio, which consists of loans secured by owner-occupied commercial real estate properties and commercial and industrial loans, was \$676.1 million, an increase of \$167.0 million, or 32.8%, compared to the business lending portfolio of \$509.1 million at December 31, 2018. The business lending portfolio at December 31, 2018 increased \$101.3 million, or 24.8%, compared to \$407.8 million at December 31, 2017.

The following table sets forth loans outstanding at December 31, 2019, which, based on remaining scheduled repayments of principal, are due in the periods indicated, as well as the amount of loans with fixed and variable rates in each maturity range. Loans with balloon payments and longer amortizations are often repriced and extended beyond the initial maturity when credit conditions remain satisfactory. Demand loans, loans having no stated schedule of repayments and no stated maturity, and overdrafts are reported below as due in one year or less.

<i>(dollars in thousands)</i>	One Year or Less	After One Year Through Five Years	After Five Years Through Ten Years	After Ten Years Through Fifteen Years	After Fifteen Years	Total
Mortgage loans on real estate:						
Construction and land development	\$ 146,587	\$ 26,422	\$ 19,189	\$ 5,314	\$ 285	\$ 197,797
1-4 Family	49,782	88,504	47,054	24,600	111,549	321,489
Multifamily	2,953	30,177	24,730	184	2,573	60,617
Farmland	7,714	11,720	7,280	315	751	27,780
Commercial real estate						
Owner-occupied	30,052	157,603	91,555	55,790	17,324	352,324
Nonowner-occupied	40,376	165,852	126,765	45,673	70	378,736
Commercial and industrial	182,280	95,196	31,137	6,931	8,242	323,786
Consumer	6,500	20,196	2,567	178	5	29,446
Total loans	\$ 466,244	\$ 595,670	\$ 350,277	\$ 138,985	\$ 140,799	\$ 1,691,975
Amounts with fixed rates	\$ 122,513	\$ 553,251	\$ 342,240	\$ 137,734	\$ 131,275	\$ 1,287,013
Amounts with variable rates	343,731	42,419	8,037	1,251	9,524	404,962
Total loans	\$ 466,244	\$ 595,670	\$ 350,277	\$ 138,985	\$ 140,799	\$ 1,691,975

Loan Concentrations. Loan concentrations are considered to exist when there are amounts loaned to multiple borrowers engaged in similar activities that would cause them to be similarly impacted by economic or other conditions. At December 31, 2019 and December 31, 2018, we had no concentrations of loans exceeding 10% of total loans other than loans in the categories listed in the table above.

Investment Securities

We purchase investment securities primarily to provide a source for meeting liquidity needs, with return on investment as a secondary consideration. We also use investment securities as collateral for certain deposits and other types of borrowing. Investment securities represented 13% of our total assets and totaled \$274.2 million at December 31, 2019, an increase of \$9.2 million, or 3.5%, from \$265.0 million at December 31, 2018. The investment securities balance at December 31, 2018 represented a \$29.4 million, or 12.5%, increase from \$235.6 million at December 31, 2017. The increase in investment securities at December 31, 2019 compared to December 31, 2018 and 2017 resulted from purchases of multiple investment types in our current portfolio.

The table below shows the carrying value of our investment securities portfolio by investment type and the percentage that such investment type comprises of our entire portfolio as of the dates indicated (dollars in thousands).

	December 31,					
	2019		2018		2017	
	Balance	Percentage of Portfolio	Balance	Percentage of Portfolio	Balance	Percentage of Portfolio
Obligations of U.S. government agencies and corporations	\$ 33,651	12.3%	\$ 7,870	3.0%	\$ 8,168	3.5%
Obligations of state and political subdivisions	42,936	15.7	44,685	16.9	47,098	20.0
Corporate bonds	19,163	6.9	15,509	5.8	16,210	6.9
Residential mortgage-backed securities	106,868	39.0	140,294	52.9	115,614	49.0
Commercial mortgage-backed securities	71,596	26.1	56,689	21.4	47,629	20.2
Equity securities	—	—	—	—	842	0.4
Total investment securities	\$ 274,214	100%	\$ 265,047	100%	\$ 235,561	100%

The investment portfolio consists of available for sale and held to maturity securities. We do not hold any investments classified as trading. We classify debt securities as held to maturity if management has the positive intent and ability to hold the securities to maturity. Held to maturity securities are stated at amortized cost. Securities not classified as held to maturity are classified as available for sale. The carrying values of the Company's available for sale securities are adjusted for unrealized gains or losses as valuation allowances, and any gains or losses are reported on an after-tax basis as a component of other comprehensive income. Any expected credit loss due to the inability to collect all amounts due according to the security's contractual terms is recognized as a charge against earnings. Any remaining unrealized loss related to other factors would be recognized in other comprehensive income, net of taxes.

Effective January 1, 2018, per the requirements of the FASB's Accounting Standards Update ("ASU") 2016-01, the carrying values of the Company's equity securities historically included in the available for sale securities portfolio are included in equity securities on the consolidated balance sheet and are adjusted for unrealized gains or losses with any changes being recognized in net income in the consolidated statement of income.

Typically, our investment securities are available for sale. There were no purchases of held to maturity securities during the years ended December 31, 2019, 2018 and 2017. In the year ended December 31, 2019, we purchased \$110.4 million of investment securities, compared to purchases of \$72.3 million and \$104.2 million of investment securities during the years ended December 31, 2018 and 2017, respectively. During the year ended December 31, 2019, we also sold \$65.6 million of investment securities, the majority of which were sold during the second quarter of 2019, as we sought to better position the balance sheet for potential reductions in short term interest rates. Mortgage-backed securities represented 65%, 68%, and 61% of the available for sale securities we purchased in 2019, 2018 and 2017, respectively. Of the remaining securities purchased in 2019, 2018 and 2017, 29%, 25%, and 33%, respectively, were U.S. government agency securities, while 4%, 1%, and 3%, respectively, were municipal securities. We only purchase corporate bonds that are investment grade securities issued by seasoned corporations.

The table below sets forth the stated maturities and weighted average yields of our investment debt securities based on the amortized cost of our investment portfolio as of December 31, 2019 (dollars in thousands).

	One Year or Less		After One Year Through Five Years		After Five Years Through Ten Years		After Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Held to maturity:								
Obligations of states and political subdivisions	\$ 790	5.88%	\$ 3,575	5.88%	\$ 5,122	5.88%	\$ —	—%
Residential mortgage-backed securities	—	—	—	—	—	—	4,922	2.85
Available for sale:								
Obligations of U.S. government agencies and corporations	—	—	2,608	2.11	26,907	3.35	4,136	3.26
Obligations of states and political subdivisions	2,174	1.94	4,694	2.34	13,552	2.64	12,500	4.15
Corporate bonds	—	—	4,139	3.53	15,106	3.65	—	—
Residential mortgage-backed securities	—	—	197	3.07	294	2.87	100,457	2.47
Commercial mortgage-backed securities	—	—	1,887	2.78	10,692	2.49	58,761	2.89
	<u>\$ 2,964</u>		<u>\$ 17,100</u>		<u>\$ 71,673</u>		<u>\$ 180,776</u>	

The maturity of mortgage-backed securities reflects scheduled repayments based upon the contractual maturities of the securities. Weighted average yields on tax-exempt obligations have been computed on a fully tax equivalent basis assuming a federal tax rate of 21%.

Premises and Equipment

Bank premises and equipment increased \$10.7 million, or 26.6%, to \$50.9 million at December 31, 2019 from \$40.2 million at December 31, 2018. The increase was mainly attributable to the completion of two acquisitions which added \$3.5 million in bank premises and equipment, the addition of right-of-use assets related to leases of \$3.3 million, and the addition of two de novo branches. Bank premises and equipment increased \$2.7 million, or 7.2%, to \$40.2 million at December 31, 2018 from \$37.5 million at December 31, 2017. The increase was primarily due to the addition of a de novo branch, equipment upgrades at branches acquired in 2017, and the interactive teller machine launched in 2018.

Deferred Tax Liability/Asset

At December 31, 2019, the net deferred tax liability was \$0.1 million, compared to net deferred tax assets of \$1.1 million and \$1.3 million at December 31, 2018 and 2017, respectively. The decrease in the deferred tax asset to a net deferred tax liability at December 31, 2019 compared to December 31, 2018 is mainly attributable to the increase in the unrealized gain on available for sale (“AFS”) securities during the period.

The Bank acquired net operating loss carryforwards as a result of acquisitions. At December 31, 2019, we held approximately \$0.5 million in net operating loss carryforwards that expire in 2033. U.S. tax law imposes annual limitations under Internal Revenue Code Section 382 on the amount of net operating loss carryforwards that may be used to offset federal taxable income. Under these laws, we may apply up to approximately \$0.1 million to offset our taxable income each year through 2023. In addition to this limitation, our ability to utilize net operating loss carryforwards depends upon the Company generating taxable income. Given the substantial amount of time before our net operating loss carryforwards begin to expire, we currently expect to utilize these net operating loss carryforwards in full before their expiration.

Deposits

The following table sets forth the composition of our deposits and the percentage of each deposit type to total deposits at December 31, 2019, 2018 and 2017 (dollars in thousands).

	December 31,					
	2019		2018		2017	
	Amount	Percentage of Total Deposits	Amount	Percentage of Total Deposits	Amount	Percentage of Total Deposits
Noninterest-bearing demand deposits	\$ 351,905	20.6%	\$ 217,457	16.0%	\$ 216,599	17.7%
Interest-bearing demand deposits	335,478	19.6	295,212	21.7	208,683	17.0
Money market deposit accounts	198,999	11.7	179,340	13.2	146,140	11.9
Savings accounts	115,324	6.8	104,146	7.6	117,372	9.6
Time deposits	706,000	41.3	565,576	41.5	536,443	43.8
Total deposits	\$ 1,707,706	100.0%	\$ 1,361,731	100.0%	\$ 1,225,237	100.0%

Total deposits were \$1.7 billion at December 31, 2019, an increase of \$346.0 million, or 25.4%, from total deposits of \$1.4 billion at December 31, 2018. The Company acquired approximately \$84.8 million in deposits from Bank of York in the fourth quarter of 2019 and \$107.6 million in deposits from Mainland Bank in the first quarter of 2019. The remaining increase is due to organic growth. Total deposits at December 31, 2018 increased \$136.5 million, or 11.1%, from total deposits of \$1.2 billion at December 31, 2017 due to organic growth.

The following table shows the contractual maturities of certificates of deposit and other time deposits greater than \$100,000 at December 31, 2019 and 2018 (dollars in thousands).

	December 31,			
	2019		2018	
	Certificates of Deposit	Other Time Deposits	Certificates of Deposit	Other Time Deposits
Time remaining until maturity:				
Three months or less	\$ 89,995	\$ 2,162	\$ 76,435	\$ 1,488
Over three months through six months	74,759	1,421	72,177	220
Over six months through twelve months	198,801	1,852	100,215	1,840
Over one year through three years	90,541	4,954	67,820	4,704
Over three years	13,935	1,629	9,737	1,835
	\$ 468,031	\$ 12,018	\$ 326,384	\$ 10,087

Borrowings

Total borrowings include securities sold under agreements to repurchase, advances from the Federal Home Loan Bank (“FHLB”), unsecured lines of credit with First National Bankers Bank (“FNBB”) and TIB-The Independent BankersBank (“TIB”) totaling \$60.0 million, subordinated debt and junior subordinated debentures.

Securities sold under agreements to repurchase increased \$1.0 million to \$3.0 million at December 31, 2019 from \$2.0 million at December 31, 2018. Our advances from the FHLB were \$131.6 million at December 31, 2019, a decrease of \$74.9 million from FHLB advances of \$206.5 million at December 31, 2018 as we utilized available capital to pay off a portion of advances. There were no funds drawn on the unsecured lines of credit at December 31, 2019 or 2018.

The average balances and cost of funds of short-term borrowings at December 31, 2019, 2018 and 2017 are summarized in the table below (dollars in thousands).

	Average Balances			Cost of Funds		
	December 31,			December 31,		
	2019	2018	2017	2019	2018	2017
Federal funds purchased and other short-term borrowings	\$ 110,603	\$ 126,670	\$ 96,774	2.09%	1.84%	1.37%
Securities sold under agreements to repurchase	2,936	18,420	32,335	1.32	0.99	0.33
Total short-term borrowings	\$ 113,539	\$ 145,090	\$ 129,109	2.07%	1.73%	1.11%

2029 Notes. On November 12, 2019, Investar Holding Corporation (“Investar”) issued \$25.0 million in aggregate principal amount of its 5.125% Fixed-to-Floating Rate Subordinated 2029 Notes due 2029 (“2029 Notes”) at 100% of their face amount in a private placement to certain institutional and other accredited investors. The 2029 Notes have a maturity date of December 30, 2029. From and including the date of issuance to, but excluding December 30, 2024, the 2029 Notes will bear interest at an initial fixed rate of 5.125% per annum, payable semi-annually in arrears. From and including December 30, 2024 and thereafter, the 2029 Notes will bear interest at a floating rate equal to the then-current three-month LIBOR as calculated on each applicable date of determination, or an alternative rate determined in accordance with the terms of the 2029 Notes if the three-month LIBOR cannot be determined, plus 3.490%, payable quarterly in arrears.

Investar may redeem the 2029 Notes, in whole or in part, on or after December 30, 2024 or, in whole but not in part, under certain limited circumstances set forth in the 2029 Notes. Any redemption by Investar would be at a redemption price equal to 100% of the principal balance being redeemed, together with any accrued and unpaid interest to the date of redemption.

Principal and interest on the 2029 Notes are not subject to acceleration, except upon certain bankruptcy-related events. The 2029 Notes are unsecured, subordinated obligations of Investar and rank junior in right of payment to Investar’s current and future senior indebtedness and to Investar’s obligations to its general creditors. The 2029 Notes are obligations of Investar only and are not obligations of, and are not guaranteed by, any of the Investar’s subsidiaries. The 2029 Notes are structured to qualify as Tier 2 capital for regulatory capital purposes.

2027 Notes. On March 24, 2017, Investar issued \$18.6 million in aggregate principal amount of its 6.00% Fixed-to-Floating Rate Subordinated Notes due 2027 (the “2027 Notes”), at 100% of the aggregate principal amount of the 2027 Notes in an offering registered under the Securities Act of 1933, as amended.

The 2027 Notes will mature on March 30, 2027. From and including the date of issuance, but excluding March 30, 2022, the 2027 Notes will bear interest at an initial fixed rate of 6.00% per annum, payable semi-annually. From and including March 30, 2022 and thereafter, the 2027 Notes will bear interest at a floating rate equal to the then-current three-month LIBOR (but not less than zero) as calculated on each applicable date of determination, plus 3.945%, payable quarterly.

Principal and interest on the 2027 Notes are not subject to acceleration, except upon certain bankruptcy-related events. The 2027 Notes are unsecured subordinated obligations of Investar. The 2027 Notes are subordinated in right of payment to the payment of Investar’s existing and future senior indebtedness, including all of its general creditors. The 2027 Notes are obligations of Investar only and are not obligations of, and are not guaranteed by, any of the Investar’s subsidiaries. Investar may, beginning with the interest payment date of March 30, 2022, and on any interest payment date thereafter, redeem the 2027 Notes, in whole or in part, at a redemption price equal to 100% of the principal amount of the 2027 Notes to be redeemed plus accrued and unpaid interest to but excluding the date of redemption. The 2027 Notes are structured to qualify as Tier 2 capital for regulatory capital purposes.

Junior subordinated debt of \$5.9 million and \$5.8 million at December 31, 2019 and 2018, respectively, represents the junior subordinated debentures that we assumed in connection with our acquisitions of BOJ Bancshares, Inc. in 2017 and First Community Bank (“FCB”) in 2013.

Results of Operations

Performance Summary

2019 vs. 2018. For the year ended December 31, 2019, net income was \$16.8 million, or \$1.68 per basic common share and \$1.66 per diluted common share, compared to net income of \$13.6 million, or \$1.41 per basic common share and \$1.39 per diluted common share, for the year ended December 31, 2018. The increases in basic and diluted earnings per common share and net income were primarily driven by an increase in net interest income resulting from both organic loan growth and loans acquired during 2019, as well as an increase in the yields on interest-earning assets, offset, in part, by an increase in the cost of funds. The increase in net interest income was partially offset by an increase in noninterest expense.

Return on average assets increased to 0.85% for the year ended December 31, 2019 from 0.81% for the year ended December 31, 2018. Return on average equity was 8.21% for the year ended December 31, 2019 compared to 7.68% for the year ended December 31, 2018. The increase in both return on average assets and return on average equity is mainly attributable to the \$3.2 million increase in net income.

2018 vs. 2017. For the year ended December 31, 2018, net income was \$13.6 million, or \$1.41 per basic common share and \$1.39 per diluted common share, compared to net income of \$8.2 million, or \$0.96 per basic and diluted common share, for the year ended December 31, 2017. The increases in basic and diluted earnings per common share and net income were primarily driven by higher levels of net interest income resulting from both organic loan growth and loans acquired during 2017, as well as an increase in the yields on interest-earning assets, offset, in part, by an increase in the cost of funds. The increase in net interest income was partially offset by an increase in noninterest expense.

Return on average assets increased to 0.81% for the year ended December 31, 2018 from 0.62% for the year ended December 31, 2017. Return on average equity was 7.68% for the year ended December 31, 2018 compared to 5.65% for the year ended December 31, 2017. The increase in both return on average assets and return on average equity is mainly attributable to the \$5.4 million increase in net income.

Net Interest Income and Net Interest Margin

Net interest income, our principal source of earnings, is the difference between the interest income generated by earning assets and the total interest cost of the deposits and borrowings obtained to fund those assets. Factors affecting the level of net interest income include the volume of earning assets and interest-bearing liabilities, yields earned on loans and investments and rates paid on deposits and other borrowings, the level of nonperforming loans, and the amount of noninterest-bearing liabilities supporting earning assets.

The primary factors affecting net interest margin are changes in interest rates, competition, and the shape of the interest rate yield curve. The Federal Reserve Board sets various benchmark rates, including the Federal Funds rate, and thereby influences the general market rates of interest, including the deposit and loan rates offered by financial institutions. The Federal Funds target rate, which is the cost to banks of immediately available overnight funds, was lowered on December 16, 2008 to a historic low of 0% to 0.25%, where it remained until December 16, 2015, when the target rate was increased slightly to 0.50% to 0.75%. Since December 31, 2015, the Federal Funds target rate increased a total of 175 basis points and remained at 2.25% to 2.50%, as of December 19, 2018, until it was lowered to 2.00 to 2.25% on July 31, 2019. The Federal Reserve further reduced the rate by 25 basis points on both September 18, 2019 to 1.75 to 2.00% and October 30, 2019 to 1.50 to 1.75%. On March 3, 2020, the Federal Reserve lowered the Federal Funds target rate to 1.00 to 1.25%, which the Federal Reserve stated was in response to the evolving risks to economic activity posed by the coronavirus.

2019 vs. 2018. Net interest income increased 13.0% to \$64.8 million for the year ended December 31, 2019 from \$57.4 million for the same period in 2018. Net interest margin was 3.51% for the year ended December 31, 2019, a decrease of 10 basis points from 3.61% for the year ended December 31, 2018. The increase in net interest income resulted from increases in both the volume of interest-earning assets and the yield earned on those assets, partially offset by an increase in the volume of and rate paid on interest-bearing liabilities. These changes were driven both by organic loan and deposit growth and growth due to acquisitions during 2019, and the current interest rate environment. For the year ended December 31, 2019, average loans and average investment securities increased approximately \$233.6 million and \$15.4 million, respectively, while average interest-bearing deposits increased approximately \$221.0 million and average total borrowings decreased approximately \$29.2 million compared to the same period in 2018.

Interest income was \$89.4 million for the year ended December 31, 2019 compared to \$73.9 million for the same period in 2018. Loan interest income made up substantially all of our interest income for the years ended December 31, 2019 and 2018. Interest on our commercial real estate loans, commercial and industrial loans, and one-to-four family residential real estate loans constituted the three largest components of our loan interest income for the year ended December 31, 2019 at 81% of total interest income on loans. Interest on our commercial real estate loans, one-to-four family residential real estate loans, and construction and development loans constituted the three largest components of our loan interest income for the year ended December 31, 2018 at 78% of total interest income on loans. The overall yield on interest-earning assets increased 19 basis points to 4.84% for the year ended December 31, 2019 compared to 4.65% for the same period in 2018. The loan portfolio yielded 5.26% for the year ended December 31, 2019 compared to 5.11% for the year ended December 31, 2018, while the yield on the investment portfolio was 2.73% for the year ended December 31, 2019 compared to 2.57% for the year ended December 31, 2018.

Interest expense was \$24.6 million for the year ended December 31, 2019, an increase of \$8.1 million compared to interest expense of \$16.5 million for the year ended December 31, 2018. While there was an increase in the volume of interest-bearing liabilities, the increase in interest expense is mainly attributable to the increase in the rate paid for these liabilities for the year ended December 31, 2019 compared to December 31, 2018. The Federal Funds target rate increased 100 basis points during the year ended December 31, 2018, which affects the rate the Company pays for immediately available overnight funds, long-term borrowings, and deposits, and did not experience a slight decrease until July 31, 2019, as discussed above. For the year ended December 31, 2019, the cost of interest-bearing deposits increased 44 basis points to 1.53% and the cost of interest-bearing liabilities increased 38 basis points to 1.67% compared to the same period in 2018.

2018 vs. 2017. Net interest income increased 34.9% to \$57.4 million for the year ended December 31, 2018 from \$42.5 million for the same period in 2017. Net interest margin was 3.61% for the year ended December 31, 2018, up 22 basis points from 3.39% for the year ended December 31, 2017. The increase in net interest income resulted from increases in both the volume of interest earning assets and the yield earned on those assets, partially offset by an increase in both the volume of and rate paid on interest bearing liabilities. These changes were driven both by organic loan and deposit growth and growth due to acquisitions during 2017, and the current interest rate environment. For the year ended December 31, 2018, average loans and average investment securities increased approximately \$292.8 million and \$43.9 million, respectively, compared to the same period in 2017, while average interest-bearing deposits and average short- and long-term borrowings increased approximately \$188.9 million and \$63.8 million, respectively.

Interest income was \$73.9 million for the year ended December 31, 2018 compared to \$53.3 million for the same period in 2017. Loan interest income made up substantially all of our interest income for the years ended December 31, 2018 and 2017. Interest on our commercial real estate loans, one-to-four family residential real estate loans and construction and development loans constituted the three largest components of our loan interest income for the years ended December 31, 2018 and December 31, 2017 at 78% and 76%, respectively, of total interest income on loans. The overall yield on interest-earning assets increased 40 basis points to 4.65% for the year ended December 31, 2018 compared to 4.25% for the same period in 2017. The loan portfolio yielded 5.11% for the year ended December 31, 2018 compared to 4.72% for the year ended December 31, 2017, while the yield on the investment portfolio was 2.57% for the year ended December 31, 2018 compared to 2.37% for the year ended December 31, 2017.

Interest expense was \$16.5 million for the year ended December 31, 2018, an increase of \$5.7 million compared to interest expense of \$10.8 million for the year ended December 31, 2017. While there was an increase in the cost of interest-bearing liabilities, the increase in interest expense is mainly attributable to the \$252.6 million increase in the volume of these liabilities for the year ended December 31, 2018 compared to December 31, 2017. In addition, the Federal Funds target rate increased 100 basis points during the year ended December 31, 2018, which affects the rate the Company pays for immediately available overnight funds, long term borrowings, and deposits. For the year ended December 31, 2018, the cost of interest-bearing deposits increased 15 basis points to 1.09% and the cost of interest-bearing liabilities increased 24 basis points to 1.29% compared to the same period in 2017.

Average Balances and Yields. The following table sets forth average balance sheet data, including all major categories of interest-earning assets and interest-bearing liabilities, together with the interest earned or paid and the average yield or rate paid on each such category as of and for the years ended December 31, 2019, 2018 and 2017. Averages presented below are daily averages (dollars in thousands).

	As of and for the year ended December 31,								
	2019			2018			2017		
	Average Balance	Interest Income/Expense ⁽¹⁾	Yield/ Rate ⁽¹⁾	Average Balance	Interest Income/Expense ⁽¹⁾	Yield/ Rate ⁽¹⁾	Average Balance	Interest Income/Expense ⁽¹⁾	Yield/ Rate ⁽¹⁾
Assets									
Interest-earning assets:									
Loans	\$ 1,539,886	\$ 80,954	5.26%	\$ 1,306,264	\$ 66,750	5.11%	\$ 1,013,502	\$ 47,863	4.72%
Securities:									
Taxable	240,751	6,650	2.76	222,948	5,793	2.60	180,769	4,265	2.36
Tax-exempt	31,780	790	2.49	34,159	815	2.39	32,427	790	2.44
Interest-earning balances with banks	34,905	1,049	3.00	24,126	533	2.21	28,524	428	1.50
Total interest-earning assets	1,847,322	89,443	4.84	1,587,497	73,891	4.65	1,255,222	53,346	4.25
Cash and due from banks	22,969			17,219			15,534		
Intangible assets	26,107			19,927			8,892		
Other assets	90,949			73,472			61,387		
Allowance for loan losses	(9,969)			(8,491)			(7,368)		
Total assets	<u>\$ 1,977,378</u>			<u>\$ 1,689,624</u>			<u>\$ 1,333,667</u>		
Liabilities and stockholders' equity									
Interest-bearing liabilities:									
Deposits:									
Interest-bearing demand	\$ 510,148	\$ 5,308	1.04%	\$ 394,336	\$ 3,206	0.81%	\$ 317,755	\$ 2,223	0.70%
Savings deposits	110,936	501	0.45	116,544	567	0.49	78,444	446	0.57
Time deposits	641,630	13,498	2.10	530,881	7,621	1.44	456,690	5,381	1.18
Total interest-bearing deposits	1,262,714	19,307	1.53	1,041,761	11,394	1.09	852,889	8,050	0.94
Short-term borrowings	113,539	2,348	2.07	145,090	2,511	1.73	129,109	1,430	1.11
Long-term debt	98,017	2,970	3.03	95,692	2,616	2.73	47,922	1,349	2.81
Total interest-bearing liabilities	1,474,270	24,625	1.67	1,282,543	16,521	1.29	1,029,920	10,829	1.05
Noninterest-bearing deposits	283,274			220,068			147,856		
Other liabilities	14,717			9,817			10,782		
Stockholders' equity	205,117			177,196			145,109		
Total liabilities and stockholders' equity	<u>\$ 1,977,378</u>			<u>\$ 1,689,624</u>			<u>\$ 1,333,667</u>		
Net interest income/net interest margin		<u>\$ 64,818</u>	<u>3.51%</u>		<u>\$ 57,370</u>	<u>3.61%</u>		<u>\$ 42,517</u>	<u>3.39%</u>

⁽¹⁾ Interest income and net interest margin are expressed as a percentage of average interest-earning assets outstanding for the indicated periods. Interest expense is expressed as a percentage of average interest-bearing liabilities for the indicated periods.

Nonaccrual loans were included in the computation of average loan balances but carry a zero yield. The yields include the effect of loan fees of \$1.9 million, \$2.1 million and \$1.4 million for the years ended December 31, 2019, 2018 and 2017, respectively, and discounts and premiums that are amortized or accreted to interest income or expense.

Volume/Rate Analysis. The following table sets forth a summary of the changes in interest earned and interest paid resulting from changes in volume and rates for the year ended December 31, 2019 compared to the year ended December 31, 2018 (dollars in thousands):

	Year ended December 31, 2019 vs. Year ended December 31, 2018		
	Volume	Rate	Net ⁽¹⁾
Interest income:			
Loans	\$ 11,939	\$ 2,265	\$ 14,204
Securities:			
Taxable	462	395	857
Tax-exempt	(57)	32	(25)
Interest-earning balances with banks	238	278	516
Total interest-earning assets	12,582	2,970	15,552
Interest expense:			
Interest-bearing demand deposits	941	1,161	2,102
Savings deposits	(27)	(39)	(66)
Time deposits	1,590	4,287	5,877
Short-term borrowings	(546)	383	(163)
Long-term debt	64	290	354
Total interest-bearing liabilities	2,022	6,082	8,104
Change in net interest income	\$ 10,560	\$ (3,112)	\$ 7,448

⁽¹⁾ Changes in interest due to both volume and rate have been allocated on a pro-rata basis using the absolute ratio value of amounts calculated.

Noninterest Income

Noninterest income includes, among other things, fees generated from our deposit services, gains on the sales of fixed assets and securities, servicing fees and fee income on serviced loans, interchange fees, and earnings on the Company's bank owned life insurance policies. We expect to continue to develop new products that generate noninterest income, and enhance our existing products, in order to diversify our revenue sources.

2019 vs. 2018. Total noninterest income increased \$1.9 million, or 44.0%, to \$6.2 million for the year ended December 31, 2019 compared to \$4.3 million for the year ended December 31, 2018. The increase is primarily due to the \$0.9 million increase in other operating income and the \$0.6 million increase in the fair value of equity securities. Other operating income includes, among other things, credit card, ATM and wire fees, and income recorded on an equity method investment. The increase in other operating income for the year ended December 31, 2019 is mainly attributable to increased activity, in part due to the completion of two acquisitions in 2019.

Service charges on deposit accounts is the largest component of our noninterest income for the year ended December 31, 2019. These service charges include maintenance fees on accounts, account enhancement charges for additional deposit account features, per item charges, overdraft fees, and treasury management charges. Service charges on deposit accounts increased 26.6% to \$1.8 million for the year ended December 31, 2019 compared to \$1.5 million for the same period in 2018.

Servicing fees and fee income on serviced loans decreased \$0.4 million, or 38.4%, to \$0.6 million, for the year ended December 31, 2019. This decrease is a result of the Bank exiting the indirect auto loan origination business at the end of 2015. Since the Bank did not originate auto loans for sale during the years ended December 31, 2019 and 2018, the servicing portfolio, which experienced regularly scheduled paydowns, was not replaced with new loans. We expect servicing fees and fee income on serviced loans to decrease over time until all serviced loans are paid off. At December 31, 2019, the weighted average remaining term of the indirect auto loan portfolio was 2.0 years.

Interchange fees, which are fees earned on the usage of the Bank's credit and debit cards, increased \$0.2 million, or 19.5%, to \$1.1 million for year ended December 31, 2019 from \$0.9 million for same period in 2018. The increase in interchange fees can primarily be attributed to the increase in the volume of debit and credit card transactions following the Company's acquisitions in 2019.

Income from bank owned life insurance increased \$0.1 million to \$0.7 million for the year ended December 31, 2019 from \$0.6 million for the same period in 2018. This increase reflects increased interest earned on the Company's bank owned life insurance policies.

Change in the fair value of equity securities for the year ended December 31, 2019 was an increase of \$0.6 million and represents the change in the fair value of marketable equity securities that, prior to January 1, 2018, were included as AFS investment securities in the Company's consolidated balance sheet. With the adoption of ASU 2016-01 on January 1, 2018, equity securities can no longer be classified as AFS, and, therefore, marketable equity securities are disclosed as equity securities on the balance sheet with changes in the fair value reflected in noninterest income.

Gains on the sale of investment securities for the year ended December 31, 2019 increased to \$0.3 million from \$14,000 for the same period in 2018. We sold approximately \$65.6 million in securities during the year ended December 31, 2019 compared to sales of \$7.0 million during the year ended December 31, 2018.

2018 vs. 2017. Total noninterest income increased \$0.5 million, or 13.2%, to \$4.3 million for the year ended December 31, 2018 compared to \$3.8 million for the year ended December 31, 2017. The increase is primarily due to the \$0.7 million increase in service charges on deposit accounts driven by the \$261.1 million increase in average deposit balances.

Service charges on deposit accounts is the largest component of our noninterest income for the year ended December 31, 2018. These service charges include maintenance fees on accounts, account enhancement charges for additional deposit account features, per item charges, overdraft fees, and treasury management charges. Service charges on deposit accounts increased 89.4% to \$1.5 million for the year ended December 31, 2018 compared to \$0.8 million for the same period in 2017.

Servicing fees and fee income on serviced loans decreased \$0.5 million, or 35.0%, to \$1.0 million, for the year ended December 31, 2018. This decrease is a result of the Bank exiting the indirect auto loan origination business at the end of 2015. Since the Bank did not originate auto loans for sale during the years ended December 31, 2018 and 2017, the servicing portfolio, which experienced regularly scheduled paydowns, was not replaced with new loans. We expect servicing fees and fee income on serviced loans to decrease over time until all serviced loans are paid off. At December 31, 2018, the weighted average remaining term of the indirect auto loan portfolio was 2.7 years.

Interchange fees, which are fees earned on the usage of the Bank's credit and debit cards, increased \$0.4 million, or 73.6%, to \$0.9 million for year ended December 31, 2018 from \$0.5 million for same period in 2017. The increase in interchange fees can primarily be attributed to the increase in the volume of debit and credit card transactions following the Company's acquisitions in 2017.

Income from bank owned life insurance increased \$0.4 million to \$0.6 million for the year ended December 31, 2018 from \$0.2 million for the same period in 2017. This increase reflects increased interest earned on the Company's bank owned life insurance policies.

Change in the fair value of equity securities for the year ended December 31, 2018 was a decrease of \$0.3 million and represents the change in the fair value of marketable equity securities that, prior to January 1, 2018, were included as available for sale investment securities in the Company's consolidated balance sheet. With the adoption of ASU 2016-01 on January 1, 2018, equity securities can no longer be classified as available for sale, and, therefore, marketable equity securities are disclosed as equity securities on the balance sheet with changes in the fair value reflected in noninterest income.

Gains on the sale of investment securities for the year ended December 31, 2018 decreased to \$14,000 from \$0.3 million for the same period in 2017. We sold approximately \$7.0 million in securities during the year ended December 31, 2018 compared to sales of \$106.4 million during the year ended December 31, 2017.

Other operating income, which, among other items, consists of ATM fees and wire fees, was \$0.5 million for the year ended December 31, 2018 compared to \$0.3 million for the same period in 2017. The increase is mainly attributable to a \$0.2 million increase in ATM fees resulting from increased activity.

Noninterest Expense

Noninterest expense includes salaries and benefits and other costs associated with the conduct of our operations. We are committed to managing our costs within the framework of our operating strategy. However, since we are focused on growth both organically and through acquisition, we expect our expenses to continue to increase as we add employees and physical locations to accommodate our growing franchise. We focus on creating synergies promptly after completing an acquisition, as this is important to our earnings success.

2019 vs. 2018. Total noninterest expense was \$48.2 million for the year ended December 31, 2019, an increase of \$6.3 million, or 15.0%, from \$41.9 million for the year ended December 31, 2018. This increase was driven by the increases in salaries and employee benefits, depreciation and amortization, and other operating expenses.

Salaries and employee benefits increased \$3.2 million, or 12.5%, to \$28.6 million for the year ended December 31, 2019, compared to \$25.5 million for the year ended December 31, 2018. The increase in salaries and employee benefits is mainly attributable the increase in employees following the acquisitions of Mainland and Bank of York, and the additional staff needed for the two de novo branches opened in October and December 2019.

Depreciation and amortization increased \$0.9 million, or 35.6%, to \$3.5 million for the year ended December 31, 2019, compared to \$2.6 million for the year ended December 31, 2018. The increase in depreciation and amortization was driven by the addition of approximately \$3.5 million in fixed assets acquired from Mainland and Bank of York. There were also various projects throughout the year, including equipment upgrades at acquired branches, as well as the addition of two de novo branches in the fourth quarter of 2019.

Other operating expenses include security, business development, FDIC and OFI assessments, bank shares and property taxes, charitable contributions, personnel training and development, filing fees, and other costs related to the operation of our business. Other operating expenses increased \$0.7 million, or 8.7%, to \$8.3 million for the year ended December 31, 2019 from \$7.7 million for the same period in 2018. The increase in other operating expenses was primarily related to increases in software and telephone expenses and bank shares tax.

Occupancy expense increased \$0.5 million, or 33.3% to \$1.8 million for the year ended December 31, 2019 from \$1.4 million for the year ended December 31, 2018. This increase is primarily attributable to building rent, as the Bank acquired leases from Mainland for two of its branch locations and entered into a lease for one of the de novo branches opened in 2019.

2018 vs. 2017. Total noninterest expense was \$41.9 million for the year ended December 31, 2018, an increase of \$9.5 million, or 29.5%, from \$32.3 million for the year ended December 31, 2017. This increase is mainly attributable to the increases in both salaries and employee benefits and other operating expenses.

Salaries and employee benefits increased \$6.8 million, or 36.3%, to \$25.5 million for the year ended December 31, 2018, compared to \$18.7 million for the year ended December 31, 2017. The increase in salaries and employee benefits is a result of the increase in employees following the acquisitions of Citizens and BOJ, the additional staff needed for the two de novo branches opened in June 2017, as well as the addition of the Commercial and Industrial lending group, including commercial lenders and related support staff, as well as other officers during the year ended December 31, 2018.

Other operating expenses include security, business development, FDIC and OFI assessments, bank shares and property taxes, charitable contributions, personnel training and development, filing fees, and other costs related to the operation of our business. Other operating expenses increased \$2.0 million, or 34.0%, to \$7.7 million for the year ended December 31, 2018 from \$5.7 million for the same period in 2017. The increase in other operating expenses is mainly attributable to a full year of operating the additional eight branch locations acquired from Citizens and BOJ, both of which were completed during the year ended December 31, 2017.

Occupancy expense increased \$0.2 million, or 19.8% to \$1.4 million for the year ended December 31, 2018 from \$1.2 million for the year ended December 31, 2017. This increase is primarily attributable to repair and maintenance costs and utilities for existing Bank premises, including the eight branch locations acquired and two de novo branches opened during 2017.

Income Tax Expense

2019 vs. 2018. Income tax expense for the year ended December 31, 2019 was \$4.1 million compared to \$3.6 million at December 31, 2018. The effective tax rate for the years ended December 31, 2019 and 2018 was 19.7% and 21.1%, respectively. The income tax expense for the year ended December 31, 2018 includes a \$0.6 million charge as a result of the revaluation of the Company's deferred tax assets and liabilities required following the enactment of the TCJA.

2018 vs. 2017. Income tax expense for the year ended December 31, 2018 was \$3.6 million compared to \$4.2 million at December 31, 2017. The effective tax rate for the years ended December 31, 2018 and 2017 was 21.1% and 34.1%, respectively. The decrease in the Company's effective tax rate for the year ended December 31, 2018 is a direct result of the TCJA, which lowered the corporate income tax rate from 35% to 21%. Refer to Note 17 to the Consolidated Financial Statements for further discussion of the TCJA.

Risk Management

The primary risks associated with our operations are credit, interest rate and liquidity risk. Credit and interest rate risk are discussed below, while liquidity risk is discussed in this section under the heading *Liquidity and Capital Resources* below.

Credit Risk and the Allowance for Loan Losses

General. The risk of loss should a borrower default on a loan is inherent in any lending activity. Our portfolio and related credit risk are monitored and managed on an ongoing basis by our risk management department, the board of directors' loan committee and the full board of directors. We utilize a 10 point risk-rating system, which assigns a risk grade to each borrower based on a number of quantitative and qualitative factors associated with a loan transaction. The risk grade categorizes the loan into one of five risk categories, based on information about the ability of borrowers to service the debt. The information includes, among other factors, current financial information about the borrower, historical payment experience, credit documentation, public information and current economic trends. These categories assist management in monitoring our credit quality. The following describes each of the risk categories, which are consistent with the definitions used in guidance promulgated by federal banking regulators:

- *Pass (Loan grades 1-6)*—Loans not meeting the criteria below are considered pass. These loans have high credit characteristics and financial strength. The borrowers at least generate profits and cash flow that are in line with peer and industry standards and have debt service coverage ratios above loan covenants and our policy guidelines. For some of these loans, a guaranty from a financially capable party mitigates characteristics of the borrower that might otherwise result in a lower grade.
- *Special Mention (grade 7)*—Loans classified as special mention possess some credit deficiencies that need to be corrected to avoid a greater risk of default in the future. For example, financial ratios relating to the borrower may have deteriorated. Often, a special mention categorization is temporary while certain factors are analyzed or matters addressed before the loan is re-categorized as either pass or substandard.
- *Substandard (grade 8)*—Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the borrower or the liquidation value of any collateral. If deficiencies are not addressed, it is likely that this category of loan will result in the Bank incurring a loss. Where a borrower has been unable to adjust to industry or general economic conditions, the borrower's loan is often categorized as substandard.
- *Doubtful (grade 9)*—Doubtful loans are substandard loans with one or more additional negative factors that makes full collection of amounts outstanding, either through repayment or liquidation of collateral, highly questionable and improbable.
- *Loss (grade 10)*—Loans classified as loss have deteriorated to such a point that it is not practicable to defer writing off the loan. For these loans, all efforts to remediate the loan's negative characteristics have failed and the value of the collateral, if any, has severely deteriorated relative to the amount outstanding. Although some value may be recovered on such a loan, it is not significant in relation to the amount borrowed.

At December 31, 2019 and December 31, 2018, there were no loans classified as loss, while there were \$0.1 million of loans classified as doubtful, \$8.7 million and \$9.5 million, respectively, of loans classified as substandard, and \$4.4 million and \$0.2 million, respectively, of loans classified as special mention as of such dates. Of our aggregate \$13.2 million and \$9.7 million doubtful, substandard and special mention loans at December 31, 2019 and December 31, 2018, respectively, \$7.1 million and \$7.5 million, respectively, were acquired and marked to fair value at the time of their acquisition. At December 31, 2017, we had no doubtful or loss loans, and we had substandard and special mention loans of \$5.7 million and \$3.1 million, respectively.

An external loan review consultant is engaged annually by the risk management department to review commercial loans, utilizing a risk-based approach designed to maximize the effectiveness of the review. In addition, credit analysts periodically review smaller dollar commercial loans to identify negative financial trends related to any one borrower, any related groups of borrowers or an industry. All loans not categorized as pass are put on an internal watch list, with quarterly reports to the board of directors. In addition, a written status report is maintained by our special assets division for all commercial loans categorized as substandard or worse. We use this information in connection with our collection efforts.

If our collection efforts are unsuccessful, collateral securing loans may be repossessed and sold or, for loans secured by real estate, foreclosure proceedings initiated. The collateral is sold at public auction for fair market value (based upon recent appraisals), with fees associated with the foreclosure being deducted from the sales price. The purchase price is applied to the outstanding loan balance. If the loan balance is greater than the sales proceeds, the deficient balance is charged-off.

Allowance for Loan Losses. The allowance for loan losses is an amount that management believes will be adequate to absorb probable losses inherent in the entire loan portfolio. The appropriate level of the allowance is based on an ongoing analysis of the loan portfolio and represents an amount that management deems adequate to provide for inherent losses, including collective impairment as recognized under ASC Topic 450, *Contingencies*. Collective impairment is calculated based on loans grouped by grade. Another component of the allowance is losses on loans assessed as impaired under ASC Topic 310, *Receivables*. The balance of these loans and their related allowance is included in management's estimation and analysis of the allowance for loan losses. Other considerations in establishing the allowance for loan losses include the nature and volume of the loan portfolio, overall portfolio quality, historical loan loss, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay, as well as trends within each of these factors. The allowance for loan losses is established after input from management as well as our risk management department and our special assets committee. We evaluate the adequacy of the allowance for loan losses on a quarterly basis. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance for loan losses was \$10.7 million at December 31, 2019, an increase compared to \$9.5 million at December 31, 2018 and \$7.9 million at December 31, 2017, as we increased our loan loss provisioning to reflect our organic loan growth.

A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. Determination of impairment is treated the same across all classes of loans. Impairment is measured on a loan-by-loan basis for, among others, all loans of \$500,000 or greater, nonaccrual loans and a sample of loans between \$250,000 and \$500,000. When we identify a loan as impaired, we measure the extent of the impairment based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole (remaining) source of repayment for the loans is the operation or liquidation of the collateral. In these cases when foreclosure is probable, we use the current fair value of the collateral, less selling costs, instead of discounted cash flows. For real estate collateral, the fair value of the collateral is based upon a recent appraisal by a qualified and licensed appraiser. If we determine that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), we recognize impairment through an allowance estimate or a charge-off recorded against the allowance. When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is on nonaccrual, all payments are applied to principal, under the cost recovery method. When the ultimate collectability of the total principal of an impaired loan is not in doubt and the loan is on nonaccrual, contractual interest is credited to interest income when received, under the cash basis method.

Impaired loans at December 31, 2019, which include all TDRs and nonaccrual loans individually evaluated for impairment for purposes of determining the allowance for loan losses, were \$2.5 million compared to \$3.3 million at December 31, 2018, and \$3.0 million at December 31, 2017. At December 31, 2019 and December 31, 2018, \$0.1 million and \$0.2 million, respectively, of the allowance for loan losses were specifically allocated to impaired loans, while \$0.3 million of the allowance was specifically allocated to such loans at December 31, 2017.

The provision for loan losses is a charge to income in an amount that management believes is necessary to maintain an adequate allowance for loan losses. The provision is based on management's regular evaluation of current economic conditions in our specific markets as well as regionally and nationally, changes in the character and size of the loan portfolio, underlying collateral values securing loans, and other factors which deserve recognition in estimating loan losses. For the years ended December 31, 2019, 2018 and 2017, the provision for loan losses was \$1.9 million, \$2.6 million, and \$1.5 million, respectively. The provision recorded in each year is primarily due to the overall organic growth in our loan portfolio.

Total loans acquired from Mainland and Bank of York had carrying values of \$83.6 million and \$46.0 million, respectively, and fair values of \$82.4 million and \$46.1 million, respectively, on the acquisition date. Acquired loans that are accounted for under ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (“ASC 310-30”), were marked to market on the date we acquired the loans to values which, in management’s opinion, reflected the estimated future cash flows, based on the facts and circumstances surrounding each respective loan at the date of acquisition. If future cash flows are not reasonably estimable, the Company accounts for the acquired loans using the cash basis method. We continually monitor these loans as part of our normal credit review and monitoring procedures for changes in the estimated future cash flows. Because ASC 310-30 does not permit carry over or recognition of an allowance for loan losses, we may be required to reserve for these loans in the allowance for loan losses through future provision for loan losses if future cash flows deteriorate below initial projections. We did not increase the allowance for loan losses for loans accounted for under ASC 310-30 during 2019, 2018 or 2017. There was no provision for loan losses charged to operating expense attributable to loans accounted for under ASC 310-30 for the years ended December 31, 2019, 2018 and 2017.

The following table presents the allocation of the allowance for loan losses by loan category as of the dates indicated (dollars in thousands).

	December 31,				
	2019	2018	2017	2016	2015
Mortgage loans on real estate:					
Construction and development	\$ 1,201	\$ 1,038	\$ 945	\$ 579	\$ 644
1-4 Family	1,490	1,465	1,287	1,377	1,213
Multifamily	387	331	332	355	246
Farmland	101	81	60	60	22
Commercial real estate	4,424	4,182	3,599	2,499	2,156
Commercial and industrial	2,609	1,641	693	759	513
Consumer	488	716	975	1,422	1,334
Total	\$ 10,700	\$ 9,454	\$ 7,891	\$ 7,051	\$ 6,128

The following table presents the amount of the allowance for loan losses allocated to each loan category as a percentage of total loans as of the dates indicated (dollars in thousands).

	December 31,				
	2019	2018	2017	2016	2015
Mortgage loans on real estate:					
Construction and development	0.07%	0.07%	0.07%	0.06%	0.09%
1-4 Family	0.09	0.10	0.10	0.15	0.16
Multifamily	0.02	0.02	0.03	0.04	0.03
Farmland	0.01	0.01	—	0.01	—
Commercial real estate	0.26	0.30	0.29	0.28	0.29
Commercial and industrial	0.15	0.12	0.06	0.09	0.07
Consumer	0.03	0.05	0.08	0.16	0.18
Total	0.63%	0.67%	0.63%	0.79%	0.82%

As discussed above, the balance in the allowance for loan losses is principally influenced by the provision for loan losses and by net loan loss experience. Additions to the allowance are charged to the provision for loan losses. Losses are charged to the allowance as incurred and recoveries on losses previously charged to the allowance are credited to the allowance at the time recovery is collected.

The table below reflects the activity in the allowance for loan losses for the periods indicated (dollars in thousands).

	Year ended December 31,				
	2019	2018	2017	2016	2015
Allowance at beginning of period	\$ 9,454	\$ 7,891	\$ 7,051	\$ 6,128	\$ 4,630
Provision for loan losses	1,908	2,570	1,540	2,079	1,865
Charge-offs:					
Mortgage loans on real estate:					
Construction and development	(51)	(24)	—	(27)	(17)
1-4 Family	(62)	(167)	—	(57)	(78)
Commercial real estate	(24)	—	—	(526)	—
Commercial and industrial	(252)	(481)	(270)	—	(58)
Consumer	(411)	(513)	(495)	(618)	(477)
Total charge-offs	(800)	(1,185)	(765)	(1,228)	(630)
Recoveries					
Mortgage loans on real estate:					
Construction and development	27	12	34	14	25
1-4 Family	27	29	7	13	12
Commercial real estate	1	—	—	1	1
Commercial and industrial	26	55	—	20	197
Consumer	57	82	24	24	28
Total recoveries	138	178	65	72	263
Net charge-offs	(662)	(1,007)	(700)	(1,156)	(367)
Balance at end of period	\$ 10,700	\$ 9,454	\$ 7,891	\$ 7,051	\$ 6,128
Net charge-offs to:					
Loans - average	0.04%	0.08%	0.07%	0.14%	0.05%
Allowance for loan losses	6.19%	10.65%	8.87%	16.39%	5.99%
Allowance for loan losses to:					
Total loans	0.63%	0.67%	0.63%	0.79%	0.82%
Nonperforming loans	171%	159%	214%	356%	254%

The allowance for loan losses to total loans ratio decreased to 0.63% at December 31, 2019 compared to 0.67% at December 31, 2018 while the allowance for loan losses to nonperforming loans ratio increased to 171% at December 31, 2019 from 159% at December 31, 2018.

The decrease in the ratio of the allowance for loan losses to total loans is primarily the result of acquired loans. As a result of the Mainland and Bank of York acquisitions in 2019, the Company is holding acquired loans that are carried net of a fair value adjustment for credit and interest rate marks and are only included in the allowance calculation to the extent that the reserve requirement calculated when using management's model used to reserve for its legacy loans exceeds the fair value adjustment. These acquired loans, which are included in our total loan balance, were not included in the allowance calculation for the years ended December 31, 2019, which caused the decrease in the allowance for loan losses to total loans compared to December 31, 2018.

Nonperforming loans were \$6.3 million, or 0.37% of total loans, at December 31, 2019, an increase of \$0.4 million compared to \$5.9 million, or 0.42% of total loans, at December 31, 2018. Included in nonperforming loans are loans acquired in 2017 and 2019 with a balance of \$4.6 million at December 31, 2019, or 73% of nonperforming loans.

Charge-offs reflect the realization of losses in the portfolio that were recognized previously through the provision for loan losses. Net charge-offs for the year ended December 31, 2019 were \$0.7 million, or 0.04% of the average loan balance. Net charge-offs for the years ended December 31, 2018 and 2017 were \$1.0 million and \$0.7 million respectively, equal to 0.08% and 0.07%, respectively, of the average loan balance for the respective periods. For the years ended December 31, 2019, 2018, and 2017, the largest category of our charge-offs was consumer loans. Net charge-offs of consumer loans as a percentage of average consumer loans for the years ended December 31, 2019, 2018, and 2017 were 1.1%, 0.7%, and 0.5%, respectively.

Management believes the allowance for loan losses at December 31, 2019 is sufficient to provide adequate protection against losses in our portfolio. Although the allowance for loan losses is considered adequate by management, there can be no assurance that this allowance will prove to be adequate over time to cover ultimate losses in connection with our loans. This allowance may prove to be inadequate due to unanticipated adverse changes in the economy or discrete events adversely affecting specific customers or industries. Our results of operations and financial condition could be materially adversely affected to the extent that the allowance is insufficient to cover such changes or events.

Nonperforming assets and restructured loans. Nonperforming assets consist of nonperforming loans and other real estate owned. Nonperforming loans are those on which the accrual of interest has stopped or loans which are contractually 90 days past due on which interest continues to accrue. Loans are ordinarily placed on nonaccrual when a loan is specifically determined to be impaired or when principal and interest is delinquent for 90 days or more. However, management may elect to continue the accrual when the estimated net available value of collateral is sufficient to cover the principal balance and accrued interest. It is our policy to discontinue the accrual of interest income on any loan for which we have reasonable doubt as to the payment of interest or principal. Nonaccrual loans are returned to an accrual status when the financial position of the borrower indicates there is no longer any reasonable doubt as to the payment of principal or interest.

Another category of assets which contribute to our credit risk is troubled debt restructurings, or restructured loans (“TDR”). A TDR is a loan for which a concession that is not insignificant has been granted to the borrower due to a deterioration of the borrower’s financial condition and subsequently performs in accordance with the new terms. Such concessions may include reduction in interest rates, deferral of interest or principal payments, principal forgiveness and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. We strive to identify borrowers in financial difficulty early and work with them to modify their loans to more affordable terms before such loans reach nonaccrual status. In evaluating whether to restructure a loan, management analyzes the long-term financial condition of the borrower, including guarantor and collateral support, to determine whether the proposed concessions will increase the likelihood of repayment of principal and interest. TDRs that are not performing in accordance with their restructured terms that are either contractually 90 days past due or placed on nonaccrual status are reported as nonperforming loans.

There were 18 loans, or credits, classified as TDRs at December 31, 2019 that totaled approximately \$1.5 million compared to 24 credits totaling \$2.2 million at December 31, 2018. Ten of the TDRs had a modification of terms through adjustments to maturity, seven were restructured through a reduction in the interest rate to a rate lower than the current market rate, and one restructured loan was considered a TDR due to forgiveness of interest due on the loan. At December 31, 2019 and 2018, two and three of the TDRs, respectively, were in default of their modified terms and are included in nonaccrual loans. The Company individually evaluates each TDR for allowance purposes, primarily based on collateral value, and excludes these loans from the loan population that is evaluated by applying qualitative factors.

The following table shows the principal amounts of nonperforming and restructured loans as of the dates indicated. All loans for which information exists about possible credit problems that would cause us to have serious doubts about the borrower’s ability to comply with the current repayment terms of the loan have been reflected in the table below (dollars in thousands).

	December 31,				
	2019	2018	2017	2016	2015
Nonaccrual loans	\$ 5,490	\$ 5,891	\$ 3,547	\$ 1,978	\$ 2,411
Accruing loans past due 90 days or more	795	58	134	1	—
Total nonperforming loans	6,285	5,949	3,681	1,979	2,411
TDRs	1,020	1,248	1,621	2,399	1,629
Total nonperforming and restructured loans	\$ 7,305	\$ 7,197	\$ 5,302	\$ 4,378	\$ 4,040
Interest income recognized on nonperforming and restructured loans	\$ 144	\$ 315	\$ 185	\$ 169	\$ 174
Interest income foregone on nonperforming and restructured loans	\$ 300	\$ 164	\$ 104	\$ 159	\$ 252

Of the total nonaccrual loans at December 31, 2019 and 2018, \$3.9 million and \$3.8 million, respectively, were acquired. We had \$2.4 million in nonaccrual loans acquired through acquisition at December 31, 2017. Nonperforming loans are comprised of accruing loans past due 90 days or more and nonaccrual loans. Nonperforming loans outstanding represented 0.37%, 0.42%, and 0.29% of total loans at December 31, 2019, 2018 and 2017, respectively.

Other Real Estate Owned. Other real estate owned consists of properties acquired through foreclosure or acceptance of a deed in lieu of foreclosure. These properties are carried at the lower of cost or fair market value based on appraised value less estimated selling costs. Losses arising at the time of foreclosure of properties are charged against the allowance for loan losses. Other real estate owned with a cost basis of \$5.1 million and \$0.1 million was sold during the years ended December 31, 2019 and 2018, respectively, resulting in a net gain of \$2,000 and a net loss of \$24,000 for the respective period, compared to a cost basis of \$0.6 million and a net gain of \$27,000 for the year ended December 31, 2017.

The following table provides details of our other real estate owned as of the dates indicated (dollars in thousands).

	December 31, 2019	December 31, 2018
Construction and development	\$ —	\$ 122
1-4 Family	133	15
Farmland	—	204
Commercial real estate	—	3,270
Total other real estate owned	<u>\$ 133</u>	<u>\$ 3,611</u>

Changes in our other real estate owned are summarized in the table below for the periods indicated (dollars in thousands).

	Year ended December 31, 2019	Year ended December 31, 2018
Balance, beginning of period	\$ 3,611	\$ 3,837
Additions	181	496
Acquired other real estate owned	1,507	—
Sales of other real estate owned	(5,148)	(155)
Write-downs	(18)	(567)
Balance, end of period	<u>\$ 133</u>	<u>\$ 3,611</u>

Interest Rate Risk

Market risk is the risk of loss from adverse changes in market prices and rates. Since the majority of our assets and liabilities are monetary in nature, our market risk arises primarily from interest rate risk inherent in our lending and deposit activities. A sudden and substantial change in interest rates may adversely impact our earnings and profitability because the interest rates borne by assets and liabilities do not change at the same speed, to the same extent, or on the same basis. Accordingly, our ability to proactively structure the volume and mix of our assets and liabilities to address anticipated changes in interest rates, as well as to react quickly to such fluctuations, can significantly impact our financial results. To that end, management actively monitors and manages our interest rate risk exposure.

The Asset/Liability Committee (“ALCO”) has been authorized by the board of directors to implement our asset/liability management policy, which establishes guidelines with respect to our exposure to interest rate fluctuations, liquidity, loan limits as a percentage of funding sources, exposure to correspondent banks and brokers and reliance on non-core deposits. The goal of the policy is to enable us to maximize our interest income and maintain our net interest margin without exposing the Bank to excessive interest rate risk, credit risk and liquidity risk. Within that framework, the ALCO monitors our interest rate sensitivity and makes decisions relating to our asset/liability composition.

Net interest income simulation is the Bank’s primary tool for benchmarking near term earnings exposure. Given the ALCO’s objective to understand the potential risk/volatility embedded within the current mix of assets and liabilities, standard rate scenario simulations assume total assets remain static (i.e. no growth).

The Bank may also use a standard gap report in its interest rate risk management process. The primary use for the gap report is to provide supporting detailed information to the ALCO’s discussion. The Bank has particular concerns with the utility of the gap report as a risk management tool because of difficulties in relating gap directly to changes in net interest income. Hence, the income simulation is the key indicator for earnings-at-risk since it expressly measures what the gap report attempts to estimate.

Short term interest rate risk management tactics are decided by the Committee where risk exposures exist out into the 1 to 2-year horizon. Tactics are formulated and presented to the Committee for discussion, modification, and/or approval. Such tactics may include asset and liability acquisitions of appropriate maturities in the cash market, loan and deposit product/pricing strategy modification, and derivatives hedging activities to the extent such activity is authorized by the Board of Directors.

Since the impact of rate changes due to mismatched balance sheet positions in the short-term can quickly and materially affect the current year's income statement, they require constant monitoring and management.

Within the gap position that management directs, we attempt to structure our assets and liabilities to minimize the risk of either a rising or falling interest rate environment. We manage our gap position for time horizons of one month, two months, three months, four to six months, seven to twelve months, 13-24 months, 25-36 months, 37-60 months and more than 60 months. The goal of our asset/liability management is for the Bank to maintain a net interest income at risk in an up or down 100 basis point environment at less than (5)%. At December 31, 2019, the Bank was within the policy guidelines for asset/liability management.

The following table depicts the estimated impact on net interest income of immediate changes in interest rates at the specified levels for the periods presented.

As of December 31, 2019	
Changes in Interest Rates (in basis points)	Estimated Increase/Decrease in Net Interest Income ⁽¹⁾
+300	—%
+200	(0.1)%
+100	0.1%
-100	(3.0)%

⁽¹⁾ The percentage change in this column represents the projected net interest income for 12 months on a flat balance sheet in a stable interest rate environment versus the projected net interest income in the various rate scenarios.

The computation of the prospective effects of hypothetical interest rate changes requires numerous assumptions regarding characteristics of new business and the behavior of existing positions. These business assumptions are based upon our experience, business plans and published industry experience. Key assumptions include asset prepayment speeds, competitive factors, the relative price sensitivity of certain assets and liabilities, and the expected life of non-maturity deposits. However, there are a number of factors that influence the effect of interest rate fluctuations on us which are difficult to measure and predict. For example, a rapid drop in interest rates might cause our loans to repay at a more rapid pace and certain mortgage-related investments to prepay more quickly than projected. This could mitigate some of the benefits of falling rates as are expected when we are in a negatively-gapped position. Conversely, a rapid rise in rates could give us an opportunity to increase our margins and stifle the rate of repayment on our mortgage-related loans which would increase our returns. As a result, because these assumptions are inherently uncertain, actual results will differ from simulated results.

Liquidity and Capital Resources

Liquidity. Liquidity is a measure of the ability to fund loan commitments and meet deposit maturities and withdrawals in a timely and cost-effective way. Cash flow requirements can be met by generating net income, attracting new deposits, converting assets to cash or borrowing funds. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit outflows, loan prepayments, and borrowings are greatly influenced by general interest rates, economic conditions, and the competitive environment in which we operate. To minimize funding risks, we closely monitor our liquidity position through periodic reviews of maturity profiles, yield and rate behaviors, and loan and deposit forecasts. Excess short-term liquidity is usually invested in overnight federal funds sold.

Our core deposits, which are deposits excluding time deposits greater than \$250,000 and deposits of municipalities and other political entities, are our most stable source of liquidity to meet our cash flow needs due to the nature of the long-term relationships generally established with our customers. Maintaining the ability to acquire these funds as needed in a variety of markets, and within ALCO compliance targets, is essential to ensuring our liquidity. At both December 31, 2019 and 2018, 68% and 66% of our total assets, respectively, were funded by core deposits.

Our investment portfolio is another alternative for meeting our cash flow requirements. Investment securities generate cash flow through principal payments and maturities, and they generally have readily available markets that allow for their conversion to cash. Some securities are pledged to secure certain deposit types or short-term borrowings (such as FHLB advances), which impacts their liquidity. At December 31, 2019, securities with a carrying value of \$89.5 million were pledged to secure deposits or borrowings, compared to \$77.6 million in pledged securities at December 31, 2018.

Other sources available for meeting liquidity needs include advances from the FHLB, repurchase agreements and other borrowings. FHLB advances are primarily used to match-fund fixed rate loans in order to minimize interest rate risk and also may be used to meet day to day liquidity needs, particularly if the prevailing interest rate on an FHLB advance compares favorably to the rates that we would be required to pay to attract deposits. At December 31, 2019, the balance of our outstanding advances with the FHLB was \$131.6 million, a decrease from \$206.5 million at December 31, 2018. The total amount of the remaining credit available to us from the FHLB at December 31, 2019 was \$594.6 million. At December 31, 2019, our FHLB borrowings were collateralized by approximately \$707.4 million of the Company's loan portfolio and \$28.1 million of the Company's investment securities.

Repurchase agreements are contracts for the sale of securities which we own with a corresponding agreement to repurchase those securities at an agreed upon price and date. Our policies limit the use of repurchase agreements to those collateralized by U.S. Treasury and agency securities. We had \$3.0 million of repurchase agreements outstanding at December 31, 2019, compared to \$2.0 million at December 31, 2018.

We maintain unsecured lines of credit with FNBB and TIB totaling \$60.0 million. These lines of credit are Fed Funds lines of credit and are used for overnight borrowing only. There were no outstanding balances on our unsecured lines of credit at December 31, 2019 or 2018.

In addition, at December 31, 2019 and 2018 we had \$43.6 million and \$18.6 million in aggregate principal amount of subordinated debt outstanding, respectively. For additional information, see Note 11 to our consolidated financial statements and see *Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations - Discussion and Analysis of Financial Condition - Borrowings*.

Our liquidity strategy is focused on using the least costly funds available to us in the context of our balance sheet composition and interest rate risk position. Accordingly, we target growth of noninterest-bearing deposits. Although we cannot directly control the types of deposit instruments our customers choose, we can influence those choices with the interest rates and deposit specials we offer. As of December 31, 2019, we do not hold any brokered deposits, as defined for federal regulatory purposes, although we do hold QwickRate® deposits, included in our time deposit balances, to address liquidity needs when rates on such deposits compare favorably with deposit rates in our markets. At December 31, 2019, we held \$101.8 million of QwickRate® deposits, an increase compared to \$56.7 million at December 31, 2018.

The following table presents, by type, our funding sources, which consist of total average deposits and borrowed funds, as a percentage of total funds and the total cost of each funding source for the years ended December 31, 2019 and 2018.

	Percentage of Total Average Deposits and Borrowed Funds		Cost of Funds	
	Year ended December 31,		Year ended December 31,	
	2019	2018	2019	2018
Noninterest-bearing demand	16%	15%	—%	—%
Interest-bearing demand	29	26	1.04	0.81
Savings	6	8	0.45	0.49
Time deposits	37	35	2.10	1.44
Short-term borrowings	6	10	2.07	1.73
Borrowed funds	6	6	3.03	2.73
Total deposits and borrowed funds	100%	100%	1.40%	1.10%

Capital Management. Our primary sources of capital include retained earnings, capital obtained through acquisitions and proceeds from the sale of our capital stock and subordinated debt. We may issue capital stock and debt securities from time to time to fund acquisitions and support our organic growth. During 2019, we issued \$25.0 million of subordinated notes and during 2017 we issued \$18.6 million of subordinated notes, both structured to qualify as Tier 2 capital for regulatory capital purposes. For additional information see *Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations - Discussion and Analysis of Financial Condition - Borrowings*.

In 2019, we issued 1,290,323 shares of common stock for net proceeds of \$28.5 million. We also issued 763,849 shares of common stock in connection with our acquisition of Mainland in 2019 and 799,559 shares of common stock in connection with our acquisition of BOJ in 2017. During 2019, we paid \$2.2 million in dividends compared to \$1.5 million in 2018 and \$0.7 million in 2017. Our board of directors has authorized a share repurchase program and during 2019 we paid \$8.3 million to repurchase our shares, compared to \$3.4 million in 2018 and \$0.5 million in 2017. At December 31, 2019, we had 326,334 shares of our common stock remaining authorized for repurchase under the program. During the first quarter of 2020, we repurchased 325,105 shares at an average price of \$20.35. On March 10, 2020, the Board of Directors approved an additional 300,000 shares of the Company's common stock for repurchase.

For additional information, see Notes 2, 11 and 14 to our consolidated financial statements. We are subject to restrictions on dividends under applicable banking laws and regulations. Please refer to the discussion under the heading "Supervision and Regulation – Dividends" in *Item 1. Business*, for more information. We are also subject to additional legal and contractual restrictions on dividends. Please refer to the discussion under the heading "Dividend Policy" in *Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities* and under the heading "Common Stock - Dividend Restrictions" in Note 14 to our consolidated financial statements.

We are subject to various regulatory capital requirements administered by the Federal Reserve and the OCC. These requirements are described in greater detail under the heading "Supervision and Regulation – Regulatory Capital Requirements" of *Item 1, Business*. Those guidelines specify capital tiers, which include the following classifications:

Capital Tiers⁽¹⁾	Tier 1 Leverage Ratio	Common Equity Tier 1 Capital Ratio	Tier 1 Capital Ratio	Total Capital Ratio	Ratio of Tangible to Total Asset
Well capitalized	5% or above	6.5% or above	8% or above	10% or above	
Adequately capitalized	4% or above	4.5% or above	6% or above	8% or above	
Undercapitalized	Less than 4%	Less than 4.5%	Less than 6%	Less than 8%	
Significantly undercapitalized	Less than 3%	Less than 3%	Less than 4%	Less than 6%	
Critically undercapitalized			2% or less		2% or less

⁽¹⁾ In order to be well capitalized or adequately capitalized, a bank must satisfy each of the required ratios in the table. In order to be undercapitalized or significantly undercapitalized, a bank would need to fall below just one of the relevant ratio thresholds in the table.

The Company and the Bank each were in compliance with all regulatory capital requirements as of December 31, 2019, 2018 and 2017. The Bank also was considered "well-capitalized" under the OCC's prompt corrective action regulations as of these dates.

The following table presents the actual capital amounts and regulatory capital ratios for the Company and the Bank as of the dates presented (dollars in thousands).

	Actual		Minimum Capital Requirement to be Well Capitalized	
	Amount	Ratio	Amount	Ratio
December 31, 2019				
Investar Holding Corporation:				
Tier 1 capital to average assets (leverage)	\$ 215,550	10.45%	\$ —	—%
Tier 1 common equity to risk-weighted assets	209,050	11.67	—	—
Tier 1 capital to risk-weighted assets	215,550	12.03	—	—
Total capital to risk-weighted assets	269,171	15.02	—	—
Investar Bank:				
Tier 1 capital to average assets (leverage)	222,316	10.77	103,223	5.00
Tier 1 common equity to risk-weighted assets	222,316	12.43	116,289	6.50
Tier 1 capital to risk-weighted assets	222,316	12.43	143,124	8.00
Total capital to risk-weighted assets	233,111	13.03	178,906	10.00
December 31, 2018				
Investar Holding Corporation:				
Tier 1 capital to average assets (leverage)	\$ 172,050	9.81%	\$ —	—%
Tier 1 common equity to risk-weighted assets	165,550	11.15	—	—
Tier 1 capital to risk-weighted assets	172,050	11.59	—	—
Total capital to risk-weighted assets	199,786	13.46	—	—
Investar Bank:				
Tier 1 capital to average assets (leverage)	187,735	10.72	87,570	5.00
Tier 1 common equity to risk-weighted assets	187,735	12.67	96,349	6.50
Tier 1 capital to risk-weighted assets	187,735	12.67	118,583	8.00
Total capital to risk-weighted assets	197,256	13.31	148,229	10.00

Off-Balance Sheet Transactions

Swap Contracts. The Bank entered into forward starting interest rate swap contracts to manage exposure against the variability in the expected future cash flows (future interest payments) attributable to changes in the 1-month LIBOR associated with the forecasted issuances of 1-month fixed rate debt arising from a rollover strategy. An interest rate swap is an agreement whereby one party agrees to pay a fixed rate of interest on a notional principal amount in exchange for receiving a floating rate of interest on the same notional amount for a predetermined period of time, from a second party. The maximum length of time over which the Bank is currently hedging its exposure to the variability in future cash flows for forecasted transactions is approximately 4.6 years. At December 31, 2019, the Bank had one derivative contract with a notional amount of \$50.0 million, while it had five derivative contracts with a total notional amount of \$50.0 million at December 31, 2018.

For the years ended December 31, 2019 and 2018, a gain of \$0.1 million, net of a \$14,000 tax expense, and a gain of \$0.1 million, net of a \$22,000 tax expense, respectively, was recognized in “Other comprehensive income (loss)” in the accompanying consolidated statement of other comprehensive income for the change in fair value of the interest rate swap. The swap contracts had a fair value of \$0.7 million and \$0.6 million as of December 31, 2019 and 2018, respectively, and have been recorded in “Other assets” in the accompanying consolidated balance sheets. The Bank expects the hedge to remain fully effective during the remaining term of the swap contract.

In the third quarter of 2019, the Company began entering into interest rate swaps that allow commercial loan customers to effectively convert a variable-rate commercial loan agreement to a fixed-rate commercial loan agreement. Under these agreements, the Company enters into a variable-rate loan agreement with a customer in addition to an interest rate swap agreement, which serves to effectively swap the customer’s variable-rate loan into a fixed-rate loan. The Company then enters into a corresponding swap agreement with a third party in order to economically hedge its exposure through the customer agreement. The interest rate swaps with both the customers and third parties are not designated as hedges under FASB Accounting Standards Codification (“ASC”) Topic 815, Derivatives and Hedging, and are marked to market through earnings. As the interest rate swaps are structured to offset

each other, changes to the underlying benchmark interest rates considered in the valuation of these instruments do not result in an impact to earnings; however, there may be fair value adjustments related to credit quality variations between counterparties, which may impact earnings as required by FASB ASC Topic 820, Fair Value Measurements. The Company did not recognize any gains or losses in other income resulting from fair value adjustments during the year ended December 31, 2019.

Unfunded Commitments. The Bank enters into loan commitments and standby letters of credit in the normal course of its business. Loan commitments are made to meet the financing needs of our customers, while standby letters of credit commit the Bank to make payments on behalf of customers when certain specified future events occur. The credit risks associated with loan commitments and standby letters of credit are essentially the same as those involved in making loans to our customers. Accordingly, our normal credit policies apply to these arrangements. Collateral (e.g., securities, receivables, inventory, equipment, etc.) is obtained based on management's credit assessment of the customer. The credit risk associated with these commitments is evaluated in a manner similar to the allowance for loan losses. The reserve for unfunded lending commitments is included in other liabilities in the balance sheet. At December 31, 2019 and 2018, the reserve for unfunded loan commitments was \$95,000 and \$66,000, respectively.

Loan commitments and standby letters of credit do not necessarily represent future cash requirements, in that while the customer typically has the ability to draw upon these commitments at any time, these commitments often expire without being drawn upon in full or at all. Virtually all of our standby letters of credit expire within one year. Our unfunded loan commitments and standby letters of credit outstanding are summarized below as of the dates indicated (dollars in thousands).

	December 31, 2019	December 31, 2018
Commitments to extend credit:		
Loan commitments	\$ 242,180	\$ 263,002
Standby letters of credit	11,475	11,114

The Company closely monitors the amount of remaining future commitments to borrowers in light of prevailing economic conditions and adjusts these commitments as necessary. The Company will continue this process as new commitments are entered into or existing commitments are renewed.

Additionally, at December 31, 2019, the Company had unfunded commitments of \$38,000 for its investment in Small Business Investment Company qualified funds.

For each of the years ended December 31, 2019 and 2018, we engaged in no off-balance sheet transactions reasonably likely to have a material effect on our financial condition, results of operations, or cash flows currently or in the future.

Contractual Obligations

The following table presents, as of December 31, 2019, significant fixed and determinable contractual obligations to third parties by payment date (dollars in thousands).

	Payments Due In:					Total
	Less Than One Year	One to Three Years	Three to Five Years	Over Five Years		
Deposits without a stated maturity ⁽¹⁾	\$ 1,001,706	\$ —	\$ —	\$ —	\$ —	\$ 1,001,706
Time deposits ⁽¹⁾	542,841	141,385	21,774	—	—	706,000
Securities sold under agreements to repurchase ⁽¹⁾	2,995	—	—	—	—	2,995
Federal Home Loan Bank advances ⁽²⁾	53,100	—	23,500	55,000	—	131,600
Subordinated debt ⁽²⁾	—	—	—	43,600	—	43,600
Junior subordinated debentures ⁽²⁾	—	—	—	6,702	—	6,702
Operating lease commitment	398	811	730	2,027	—	3,966
Total contractual obligations	\$ 1,601,040	\$ 142,196	\$ 46,004	\$ 107,329	\$ —	\$ 1,896,569

⁽¹⁾ Excludes interest.

⁽²⁾ Excludes unamortized premiums and discounts.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

The information contained in the section captioned “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Risk Management” in *Item 7* hereof is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data

Management's Report on Internal Control over Financial Reporting

To the Stockholders and Board of Directors
Investar Holding Corporation
Baton Rouge, Louisiana

Investar Holding Corporation (the "Company") is responsible for the preparation, integrity and fair presentation of the consolidated financial statements included in this annual report. The consolidated financial statements and notes included in this annual report have been prepared in conformity with accounting principles generally accepted in the United States of America and necessarily include some amounts that are based on management's best estimates and judgments.

Management of the Company is responsible for establishing and maintaining effective internal control over financial reporting designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. The Company's internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

The system of internal control over financial reporting as it relates to the financial statements is evaluated for effectiveness by management and tested for reliability through a program of internal audits. Actions are taken to correct potential deficiencies as they are identified. Any system of internal control, no matter how well designed, has inherent limitations, including the possibility that a control can be circumvented or overridden, and misstatements due to error or fraud may occur and not be detected. Also, because of changes in conditions, internal control effectiveness may vary over time. Accordingly, even an effective system of internal control will provide only reasonable assurance with respect to financial statement preparation.

Management, with the participation of the Company's principal executive officer and principal financial officer, conducted an assessment of the effectiveness of the Company's system of internal control over financial reporting as of December 31, 2019, based on criteria for effective internal control over financial reporting described in the "Internal Control - Integrated Framework," (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management has concluded that, as of December 31, 2019, the Company's system of internal control over financial reporting is effective and meets the criteria of the "Internal Control - Integrated Framework."

As permitted, management excluded from its assessment the operations of Bank of York, acquired on November 1, 2019. Loans and deposits acquired and excluded from management's assessment of internal controls over financial reporting comprised approximately 3% and 7% of consolidated total loans and deposits, respectively, at December 31, 2019.

Ernst & Young LLP, the Company's independent registered public accounting firm that has audited the Company's financial statements included in this annual report, has issued an attestation report on the Company's internal control over financial reporting which is included herein.

Date: March 13, 2020

By: /s/ John J. D'Angelo
John J. D'Angelo
President and Chief Executive Officer

Date: March 13, 2020

By: /s/ Christopher L. Hufft
Christopher L. Hufft
Executive Vice President and Chief Financial Officer

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Investar Holding Corporation

Opinion on Internal Control over Financial Reporting

We have audited Investar Holding Corporation's internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). In our opinion, Investar Holding Corporation (the Company) maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on the COSO criteria.

As indicated in the accompanying Management's Report on Internal Control over Financial Reporting, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Bank of York, which is included in the 2019 consolidated financial statements of the Company and constituted 3% and 7% of consolidated loans and deposits, respectively, as of December 31, 2019. Our audit of internal control over financial reporting of the Company also did not include an evaluation of the internal control over financial reporting of Bank of York.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of December 31, 2019 and 2018, the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2019, and the related notes and our report dated March 13, 2020 expressed an unqualified opinion thereon.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Ernst & Young LLP

New Orleans, Louisiana
March 13, 2020

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Investar Holding Corporation

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Investar Holding Corporation (the Company) as of December 31, 2019 and 2018, the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2019, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2019 and 2018, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2019 ended, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated March 13, 2020 expressed an unqualified opinion thereon.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Ernst & Young LLP

We have served as the Company's auditor since 2017.

New Orleans, Louisiana
March 13, 2020

INVESTAR HOLDING CORPORATION
CONSOLIDATED BALANCE SHEETS
(Amounts in thousands, except share data)

	December 31,	
	2019	2018
ASSETS		
Cash and due from banks	\$ 23,769	\$ 15,922
Interest-bearing balances due from other banks	20,539	1,212
Federal funds sold	387	6
Cash and cash equivalents	44,695	17,140
Available for sale securities at fair value (amortized cost of \$258,104 and \$253,504, respectively)	259,805	248,981
Held to maturity securities at amortized cost (estimated fair value of \$14,480 and \$15,805, respectively)	14,409	16,066
Loans, net of allowance for loan losses of \$10,700 and \$9,454, respectively	1,681,275	1,391,371
Equity securities	19,315	13,562
Bank premises and equipment, net of accumulated depreciation of \$12,432 and \$9,898, respectively	50,916	40,229
Other real estate owned, net	133	3,611
Accrued interest receivable	7,913	5,553
Deferred tax asset	—	1,145
Goodwill and other intangible assets, net	31,035	19,787
Bank owned life insurance	32,014	23,859
Other assets	7,406	5,165
Total assets	\$ 2,148,916	\$ 1,786,469
LIABILITIES		
Deposits:		
Noninterest-bearing	\$ 351,905	\$ 217,457
Interest-bearing	1,355,801	1,144,274
Total deposits	1,707,706	1,361,731
Advances from Federal Home Loan Bank	131,600	206,490
Repurchase agreements	2,995	1,999
Subordinated debt, net of unamortized issuance costs	42,826	18,215
Junior subordinated debt	5,897	5,845
Accrued taxes and other liabilities	15,916	9,927
Total liabilities	1,906,940	1,604,207
STOCKHOLDERS' EQUITY		
Preferred stock, no par value per share; 5,000,000 shares authorized	—	—
Common stock, \$1.00 par value per share; 40,000,000 shares authorized; 11,228,775 and 9,484,219 shares issued and outstanding, respectively	11,229	9,484
Surplus	168,658	130,133
Retained earnings	60,198	45,721
Accumulated other comprehensive income (loss)	1,891	(3,076)
Total stockholders' equity	241,976	182,262
Total liabilities and stockholders' equity	\$ 2,148,916	\$ 1,786,469

See accompanying notes to the consolidated financial statements.

INVESTAR HOLDING CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Amounts in thousands, except share data)

	For the years ended December 31,		
	2019	2018	2017
INTEREST INCOME			
Interest and fees on loans	\$ 80,954	\$ 66,750	\$ 47,863
Interest on investment securities	7,440	6,608	5,055
Other interest income	1,049	533	428
Total interest income	89,443	73,891	53,346
INTEREST EXPENSE			
Interest on deposits	19,307	11,394	8,050
Interest on borrowings	5,318	5,127	2,779
Total interest expense	24,625	16,521	10,829
Net interest income	64,818	57,370	42,517
Provision for loan losses	1,908	2,570	1,540
Net interest income after provision for loan losses	62,910	54,800	40,977
NONINTEREST INCOME			
Service charges on deposit accounts	1,840	1,453	767
Gain on sale of investment securities, net	262	14	292
(Loss) gain on sale of fixed assets, net	(11)	98	127
Gain (loss) on sale of other real estate owned, net	2	(24)	27
Servicing fees and fee income on serviced loans	593	963	1,482
Interchange fees	1,114	932	537
Income from bank owned life insurance	703	628	245
Change in the fair value of equity securities	341	(267)	—
Other operating income	1,372	521	338
Total noninterest income	6,216	4,318	3,815
Income before noninterest expense	69,126	59,118	44,792
NONINTEREST EXPENSE			
Depreciation and amortization	3,462	2,553	1,865
Salaries and employee benefits	28,643	25,469	18,681
Occupancy	1,837	1,378	1,150
Data processing	2,360	2,090	1,690
Marketing	260	237	422
Professional fees	1,189	1,051	950
Acquisition expense	2,090	1,445	1,868
Other operating expenses	8,327	7,659	5,716
Total noninterest expense	48,168	41,882	32,342
Income before income tax expense	20,958	17,236	12,450
Income tax expense	4,119	3,630	4,248
Net income	\$ 16,839	\$ 13,606	\$ 8,202
EARNINGS PER SHARE			
Basic earnings per share	\$ 1.68	\$ 1.41	\$ 0.96
Diluted earnings per share	1.66	1.39	0.96
Cash dividends declared per common share	0.23	0.17	0.10

See accompanying notes to the consolidated financial statements.



INVESTAR HOLDING CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Amounts in thousands)

	For the years ended December 31,		
	2019	2018	2017
Net income	\$ 16,839	\$ 13,606	\$ 8,202
Other comprehensive income (loss):			
Unrealized gain (loss) on investment securities:			
Unrealized gain (loss), available for sale, net of tax expense (benefit) of \$1,362, (\$419), and \$88, respectively	5,123	(1,576)	330
Reclassification of realized gain, net of tax expense of \$56, \$3, and \$61, respectively	(206)	(11)	(231)
Unrealized loss, transfer from available for sale to held to maturity, net of tax benefit of \$0, \$0, and \$0, respectively	(1)	(2)	(1)
Fair value of derivative financial instruments			
Change in fair value of interest rate swap designated as a cash flow hedge, net of tax expense of \$14, \$22, and \$107, respectively	51	84	402
Total other comprehensive income (loss)	4,967	(1,505)	500
Total comprehensive income	\$ 21,806	\$ 12,101	\$ 8,702

See accompanying notes to the consolidated financial statements.

INVESTAR HOLDING CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Amounts in thousands, except share data)

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance, December 31, 2016	\$ 7,102	\$ 81,499	\$ 26,227	\$ (2,071)	\$ 112,757
Common stock issued in offering, net of direct costs of \$1,991	1,624	30,885	—	—	32,509
Common stock issued in acquisition, net of issuance costs	800	17,896	—	—	18,696
Surrendered shares	(8)	(160)	—	—	(168)
Shares repurchased	(23)	(483)	—	—	(506)
Options and warrants exercised	87	1,085	—	—	1,172
Dividends declared, \$0.10 per share	—	—	(948)	—	(948)
Stock-based compensation and other activity	(67)	853	—	—	786
Net tax effect of stock-based compensation	—	7	—	—	7
Net income	—	—	8,202	—	8,202
Other comprehensive income, net ⁽¹⁾	—	—	(278)	500	222
Balance, December 31, 2017	\$ 9,515	\$ 131,582	\$ 33,203	\$ (1,571)	\$ 172,729
Surrendered shares	(9)	(210)	—	—	(219)
Shares repurchased	(132)	(3,236)	—	—	(3,368)
Options and warrants exercised	76	960	—	—	1,036
Dividends declared, \$0.17 per share	—	—	(1,640)	—	(1,640)
Stock-based compensation	34	1,037	—	—	1,071
Reclassification of tax effects of the Tax Cuts and Jobs Act ⁽²⁾	—	—	557	—	557
Net income	—	—	13,606	—	13,606
Other comprehensive loss, net	—	—	—	(1,505)	(1,505)
Impact of adoption of new accounting standards ⁽³⁾	—	—	(5)	—	(5)
Balance, December 31, 2018	\$ 9,484	\$ 130,133	\$ 45,721	\$ (3,076)	\$ 182,262
Common stock issued in offering, net of direct costs of \$1,475	1,290	27,235	—	—	28,525
Common stock issued in acquisition, net of issuance costs	764	17,873	—	—	18,637
Surrendered shares	(11)	(272)	—	—	(283)
Shares repurchased	(360)	(7,966)	—	—	(8,326)
Options and warrants exercised	21	266	—	—	287
Dividends declared, \$0.23 per share	—	—	(2,362)	—	(2,362)
Stock-based compensation	41	1,389	—	—	1,430
Net income	—	—	16,839	—	16,839
Other comprehensive income, net	—	—	—	4,967	4,967
Balance, December 31, 2019	\$ 11,229	\$ 168,658	\$ 60,198	\$ 1,891	\$ 241,976

⁽¹⁾ The Tax Cuts and Jobs Act ("TCJA"), enacted on December 22, 2017, required the revaluation of the Company's deferred tax assets and liabilities as of December 31, 2017 as a result of the lower corporate tax rates to be realized beginning January 1, 2018. The \$0.3 million adjustment to retained earnings represents the reclassification of the tax effects, or "stranded OCI" remaining in accumulated other comprehensive income after the revaluation of the Company's deferred tax assets and liabilities.

⁽²⁾ The \$0.6 million adjustment to retained earnings for the period ended December 31, 2018 represents a reclassification of the tax effects of the TCJA.

⁽³⁾ Represents the impact of adopting ASU No. 2016-01. See Note 1 to the consolidated financial statements for more information.

See accompanying notes to the consolidated financial statements.

INVESTAR HOLDING CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in thousands)

	For the years ended December 31,		
	2019	2018	2017
Cash flows from operating activities			
Net income	\$ 16,839	\$ 13,606	\$ 8,202
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	3,462	2,553	1,865
Provision for loan losses	1,908	2,570	1,540
Amortization of purchase accounting adjustments	(1,425)	(2,180)	(489)
Provision for other real estate owned	18	567	183
Net amortization of securities	712	478	1,114
Gain on sale of investment securities, net	(262)	(14)	(292)
Loss (gain) on sale of fixed assets, net	11	(98)	(127)
(Gain) loss on sale of other real estate owned, net	(2)	24	(27)
FHLB stock dividend	(336)	(239)	(99)
Stock-based compensation	1,430	1,071	786
Deferred taxes	153	841	245
Net change in value of bank owned life insurance	(703)	(628)	(245)
Amortization of subordinated debt issuance costs	53	46	35
Change in the fair value of equity securities	(341)	267	—
Net change in:			
Accrued interest receivable	(1,925)	(865)	(321)
Other assets	(2,015)	995	(639)
Accrued taxes and other liabilities	990	(2,582)	(2,274)
Net cash provided by operating activities	18,567	16,412	9,457
Cash flows from investing activities			
Proceeds from sales of investment securities available for sale	65,834	7,021	106,448
Purchases of securities available for sale	(110,431)	(72,258)	(104,209)
Proceeds from maturities, prepayments and calls of investment securities available for sale	39,578	30,545	29,295
Proceeds from maturities, prepayments and calls of investment securities held to maturity	1,623	1,884	2,021
Proceeds from redemption or sale of equity securities	2,986	1,299	2,000
Purchases of equity securities	(7,040)	(4,265)	(4,844)
Net increase in loans	(162,025)	(141,505)	(133,708)
Proceeds from sales of other real estate owned	5,150	132	591
Purchases of other real estate owned	—	(257)	—
Proceeds from sales of fixed assets	—	19	625
Purchases of fixed assets	(7,918)	(4,936)	(2,081)
Purchase of bank owned life insurance	(5,023)	—	(15,000)
Purchase of other investments	(95)	(119)	(711)
Distributions from investments	162	39	24
Cash acquired from Mainland Bank	38,365	—	—
Cash acquired from Bank of York, net of cash paid	35,771	—	—
Cash paid for Citizens Bank, net of cash acquired	—	—	(1,235)
Cash acquired from BOJ Baneshares, Inc., net of cash paid	—	—	22,436
Net cash used in investing activities	(103,063)	(182,401)	(98,348)

INVESTAR HOLDING CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED
(Amounts in thousands)

	For the years ended December 31,		
	2019	2018	2017
Cash flows from financing activities			
Net increase (decrease) in customer deposits	153,403	136,644	(20,467)
Net decrease in repurchase agreements	(9,329)	(19,936)	(17,152)
Net (decrease) increase in short-term FHLB advances	(86,400)	22,900	43,500
Proceeds from long-term FHLB advances	23,500	75,000	55,000
Repayment of long-term FHLB advances	(12,000)	(58,100)	(20,603)
Cash dividends paid on common stock	(2,167)	(1,468)	(722)
Payments to repurchase common stock	(8,326)	(3,368)	(506)
Proceeds from common stock offering, net of issuance costs	28,525	—	32,509
Proceeds from stock options and warrants exercised	287	1,036	1,172
Proceeds from other borrowings	—	—	78
Repayments of other borrowings	—	—	(1,078)
Proceeds from subordinated debt, net of issuance costs	24,558	—	18,133
Net cash provided by financing activities	112,051	152,708	89,864
Net increase (decrease) in cash and cash equivalents	27,555	(13,281)	973
Cash and cash equivalents, beginning of period	17,140	30,421	29,448
Cash and cash equivalents, end of period	\$ 44,695	\$ 17,140	\$ 30,421

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash payments for:

Income taxes	\$ 4,190	\$ 2,555	\$ 4,375
Interest on deposits and borrowings	24,396	16,139	10,201

SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING ACTIVITIES

Transfer from loans to other real estate owned	\$ 133	\$ 239	\$ 42
Transfer from bank premises and equipment to other assets	—	—	1,146

See accompanying notes to the consolidated financial statements.

INVESTAR HOLDING CORPORATION
Notes to Consolidated Financial Statements

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Investar Holding Corporation (the “Company”) is a financial holding company headquartered in Baton Rouge, Louisiana, that provides, through its wholly-owned subsidiary, Investar Bank, National Association (the “Bank”), full banking services, excluding trust services, tailored primarily to meet the needs of individuals and small to medium-sized businesses throughout its markets in south Louisiana, southeast Texas and west Alabama.

Basis of Presentation

The consolidated financial statements of Investar Holding Corporation and its wholly-owned subsidiary, the Bank, have been prepared in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”) and to generally accepted practices within the banking industry.

Segments

While our chief decision maker monitors the revenue streams of the various banking products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Accordingly, all of the Company’s banking operations are considered by management to be aggregated in one reportable operating segment. Because the overall banking operations comprise substantially all of the consolidated operations, no separate segment disclosures are presented in the accompanying consolidated financial statements.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates, and such differences could be material.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company’s allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the allowance for loan losses may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

Other estimates that are susceptible to significant change in the near term relate to the allowance for off-balance sheet credit losses, the fair value of stock-based compensation awards, the determination of other-than-temporary impairments of securities, and the fair value of financial instruments.

Investment Securities

The Company’s investments in securities are accounted for in accordance with applicable guidance contained in the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”), which requires the classification of securities into one of the following categories:

- Securities to be held to maturity (“HTM”): bonds, notes, and debentures for which the Company has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity.

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- Securities available for sale (“AFS”): available for sale securities consist of bonds, notes, and debentures that are available to meet the Company’s operating needs. These securities are reported at fair value.

Unrealized holding gains and losses, net of tax, on available for sale securities are reported as a net amount in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Realized gains and losses on the sale of debt and equity securities are determined using the specific-identification method and average price method, respectively.

The Company follows FASB guidance related to the recognition and presentation of other-than-temporary impairment. The guidance specifies that if an entity does not have the intent to sell a debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss. When an entity does not intend to sell the security, and it is more likely than not that the entity will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income.

Equity Securities

The Company is a member of the Federal Home Loan Bank (“FHLB”) system. Members of the FHLB are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, is restricted as to redemption, and is periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income. Equity securities also include investments in our other correspondent banks including Independent Bankers Financial Corporation (“IBFC”) and First National Bankers Bank (“FNBB”) stock. These investments are carried at cost which approximates fair value. The balance of equity securities in our correspondent banks at December 31, 2019 and 2018 was \$17.2 million and \$11.9 million, respectively.

In addition, at December 31, 2018, equity securities include securities previously held as available for sale securities prior to January 1, 2018. See *Impact of New Accounting Pronouncements* below for more details. These securities are marketable securities in corporate stocks and totaled \$2.1 million at December 31, 2019.

Loans

The Company’s loan portfolio categories include real estate, commercial and consumer loans. Real estate loans are further categorized into construction and development, one-to-four family residential, multifamily, farmland and commercial real estate loans. The consumer loan category includes loans originated through indirect lending. Indirect lending, which is lending initiated through third-party business partners, is largely comprised of loans made through automotive dealerships.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are stated at the unpaid principal balance outstanding, net of purchase premiums or discounts, deferred income (net of costs), any direct principal charge-offs, and an allowance for loan losses. Interest on loans is calculated by using the effective interest rate on daily balances of the principal amount outstanding. Loan origination fees, net of direct loan origination costs, and commitment fees, are deferred and amortized as an adjustment to yield over the life of the loan, or over the commitment period, as applicable.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are ordinarily placed on nonaccrual when a loan is specifically determined to be impaired or when principal or interest is delinquent for 90 days or more; however, management may elect to continue the accrual when the estimated net realizable value of collateral is sufficient to cover the principal balance and the accrued interest. Any unpaid interest previously accrued on nonaccrual loans is reversed from income. Interest income, generally, is not recognized on specific impaired loans unless the likelihood of further loss is remote. Interest payments received on such loans are applied as a reduction of the loan principal balance. Interest income on other nonaccrual loans is recognized only to the extent of interest payments received. A loan may be returned to accrual status when all the principal and interest amounts contractually due are brought current and future principal and interest amounts contractually due are reasonably assured, which is typically evidenced by a sustained period of repayment performance by the borrower.

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The Company considers a loan to be impaired when, based upon current information and events, it believes it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. The Company's impaired loans include troubled debt restructurings and performing and non-performing loans for which full payment of principal or interest is not expected. Large groups of smaller balance homogenous loans are collectively evaluated for impairment. The Company calculates an allowance required for impaired loans based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or the fair value of its collateral. If the recorded investment in the impaired loan exceeds the measure of fair value, a valuation allowance is required as a component of the allowance for loan losses. Changes to the valuation allowance are recorded as a component of the provision for loan losses.

The Company follows the FASB accounting guidance on sales of financial assets, which includes participating interests in loans. For loan participations that are structured in accordance with this guidance, the sold portions are recorded as a reduction of the loan portfolio. Loan participations that do not meet the criteria are accounted for as secured borrowings.

See *Acquisition Accounting* and *Acquired Impaired Loans* below for accounting treatment of loans acquired through business acquisitions.

Allowance for Loan Losses

The adequacy of the allowance for loan losses is determined in accordance with U.S. GAAP. The allowance for loan losses is estimated through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the loan balance is uncollectable. Subsequent recoveries, if any, are credited to the allowance.

The allowance is an amount that management believes will be adequate to absorb probable losses inherent in the loan portfolio as of the balance sheet date based on evaluations of the collectability of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated cash flows. Credits deemed uncollectible are charged to the allowance. Provisions for loan losses and recoveries on loans previously charged off are adjusted to the allowance. Past due status is determined based on contractual terms.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. Based on management's review and observations made through qualitative review, management may apply qualitative adjustments to determine loss estimates at a group and/or portfolio segment level as deemed appropriate. Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in its portfolio and portfolio segments. The Company utilizes an internally developed model that requires judgment to determine the estimation method that fits the credit risk characteristics of the loans in its portfolio and portfolio segments. Qualitative and environmental factors that may not be directly reflected in quantitative estimates include: asset quality trends, changes in loan concentrations, new products and process changes, changes and pressures from competition, changes in lending policies and underwriting practices, trends in the nature and volume of the loan portfolio, changes in experience and depth of lending staff and management and national and regional economic trends. The Company also considers third party or comparable company loss data. Changes in these factors are considered in determining changes in the allowance for loan losses. The impact of these factors on the Company's qualitative assessment of the allowance for loan losses can change from period to period based on management's assessment of the extent to which these factors are already reflected in historic loss rates. The uncertainty inherent in the estimation process is also considered in evaluating the allowance for loan losses.

In the ordinary course of business, the Bank enters into commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the financial statements when they become payable. The credit risk associated with these commitments is evaluated in a manner similar to the allowance for loan losses. The reserve for unfunded lending commitments is included in other liabilities in the consolidated balance sheet. At December 31, 2019 and 2018 the reserve for unfunded loan commitments was \$95,000 and \$66,000, respectively.

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Troubled Debt Restructurings

The Company periodically grants concessions to its customers in an attempt to protect as much of its investment as possible and minimize the risk of loss. These concessions may include restructuring the terms of a customer loan, thereby adjusting the customer's payment requirements. In accordance with the FASB's Accounting Standards Update ("ASU") 2011-2, *Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*, in order to be considered a troubled debt restructuring (a "TDR"), the Company must conclude that the restructuring constitutes a concession and the customer is experiencing financial difficulties. The Company defines a concession to a customer as a modification of existing loan terms for economic or legal reasons that it would otherwise not consider. Concessions are typically granted through an agreement with the customer or are imposed by a court of law. Concessions include modifying original loan terms to reduce or defer cash payments required as part of the loan agreement, including but not limited to a reduction of the stated interest rate for the remaining original life of the debt, an extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk characteristics, a reduction of the face amount or maturity amount of the debt, or a reduction of accrued interest receivable on a debt. In its determination of whether the customer is experiencing financial difficulties, the Company considers numerous indicators, including but not limited to, whether the customer has declared or is in the process of declaring bankruptcy, whether there is substantial doubt about the customer's ability to continue as a going concern, whether the Company believes the customer's future cash flows will be insufficient to service the debt in accordance with the contractual terms of the existing agreement for the foreseeable future, and whether without modification the customer cannot obtain sufficient funds from other sources at an effective interest rate equal to the current market rate for similar debt for a non-troubled debtor.

If the Company concludes that both a concession has been granted and the concession was granted to a customer experiencing financial difficulties, the Company identifies the loan as a TDR. For purposes of the determination of an allowance for loan losses on these TDRs, the loan is reviewed for specific impairment in accordance with the Company's allowance for loan loss methodology. If it is determined that losses are probable on such TDRs, either because of delinquency or other credit quality indicators, the Company establishes specific reserves for these loans.

Other Real Estate Owned

Real estate acquired through foreclosure, or other real estate owned on the consolidated balance sheets, is initially recorded at fair value at the time of foreclosure, less estimated selling cost, and any related write down is charged to the allowance for loan losses. Valuations are periodically performed by management and provisions for estimated losses on other real estate owned are charged to expense when fair value is determined to be less than the carrying value.

Costs relative to the development and improvement of properties are capitalized to the extent realizable, whereas ordinary upkeep disbursements are charged to expense. The ability of the Company to recover the carrying value of real estate is based upon future sales of the other real estate owned. The ability to affect such sales is subject to market conditions and other factors, many of which are beyond the Company's control. Operating income and expense of such properties is included in other operating income or expense, respectively, on the accompanying consolidated statements of income. Gain or loss on the disposition of such properties is included in noninterest income on the consolidated statements of income.

Bank Premises and Equipment

Land is carried at cost. Buildings and equipment are stated at cost, less accumulated depreciation. Depreciation expense is computed by the straight-line method and is charged to expense over the estimated useful lives of the assets, which range from 1 to 39 years. Costs of major additions and improvements are capitalized. Expenditures for maintenance and repairs are expensed as incurred. Gains or losses on the disposition of land, buildings, and equipment are included in noninterest income on the consolidated statements of income.

Bank Owned Life Insurance

The Company invests in bank owned life insurance ("BOLI") policies that provide earnings to help cover the cost of employee benefit plans. The Company is the owner and beneficiary of the life insurance policies it purchased directly on a chosen group of employees. The policies are carried on the Company's consolidated balance sheet at their cash surrender value and are subject to regulatory capital requirements. The determination of the cash surrender value includes a full evaluation of the contractual terms of each policy and assumes the surrender of policies on an individual-life by individual-life basis. Additionally, the Company periodically reviews the creditworthiness of the insurance companies that have underwritten the policies. Earnings accruing to the Company are derived from the general account investments of the insurance companies. Increases in the net cash surrender value of BOLI policies and insurance proceeds received are not taxable and are recorded in noninterest income in the consolidated statements of income.

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Goodwill and Other Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of the net identifiable assets acquired in a business combination. Goodwill and other intangible assets deemed to have an indefinite useful life are not amortized but instead are subject to review for impairment annually, or more frequently if deemed necessary, in accordance with the provisions of FASB ASC Topic 350, *Intangibles – Goodwill and Other*.

Intangible assets with estimable useful lives are amortized over their respective estimated useful lives and reviewed for impairment in accordance with FASB ASC Topic 360, *Property, Plant, and Equipment*. If impaired, the asset is written down to its estimated fair value. No impairment charges have been recognized through December 31, 2019. Core deposit intangibles representing the value of the acquired core deposit base are generally recorded in connection with business combinations involving banks and branch locations. The Company's policy is to amortize core deposit intangibles over the estimated useful life of the deposit base. The remaining useful lives of core deposit intangibles are evaluated periodically to determine whether events and circumstances warrant revision of the remaining period of amortization. The Company's core deposit intangibles are currently amortized using the sum-of-the-years-digits basis over 10 to 15 years. See Note 8, Goodwill and Other Intangible Assets, for additional information.

Repurchase Agreements

Securities sold under agreements to repurchase are secured borrowings treated as financing activities and are carried at the amounts at which the securities will be subsequently reacquired as specified in the respective agreements.

Stock-Based Compensation

The Company accounts for stock-based compensation under the provisions of ASC Topic 718, *Compensation - Stock Compensation*. Under this accounting guidance, fair value is established as the measurement objective in accounting for share-based payment awards and requires the application of a fair value based measurement method in accounting for compensation costs, which is recognized over the requisite service period. The impact of forfeitures of share-based payment awards on compensation expense is recognized as forfeitures occur. See Note 15, Stock-Based Compensation, for further disclosures regarding stock-based compensation.

Off-Balance Sheet Credit-Related Financial Instruments

The Company accounts for its guarantees in accordance with the provisions of ASC Topic 460, *Guarantees*. In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under credit card agreements, commercial letters of credit and standby letters of credit. Such financial instruments are recorded when they are funded.

Derivative Financial Instruments

ASC Topic 815, *Derivatives and Hedging*, requires that all derivatives be recognized as assets or liabilities in the balance sheet at fair value. Derivatives executed with the same counterparty are generally subject to master netting arrangements, however, fair value amounts recognized for derivative financial instruments and fair value amounts recognized for the right/obligation to reclaim/return cash collateral are not offset for financial reporting purposes.

In the course of its business operations, the Company is exposed to certain risks, including interest rate, liquidity and credit risk. The Company manages its risks through the use of derivative financial instruments, primarily through management of exposure due to the receipt or payment of future cash amounts based on interest rates. The Company's derivative financial instruments manage the differences in the timing, amount and duration of expected cash receipts and payments.

Derivatives which are designated and qualify as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. The effective portion of the derivative's gain or loss is initially reported as a component of other comprehensive income and subsequently reclassified into earnings when the forecasted transaction affects earnings or when the hedge is terminated. The ineffective portion of the gain or loss is reported in earnings immediately.

In applying hedge accounting for derivatives, the Company establishes a method for assessing the effectiveness of the hedging derivative and a measurement approach for determining the ineffective aspect of the hedge upon the inception of the hedge. These methods are consistent with the Company's approach to managing risk. Note 13, Derivative Financial Instruments, describes the derivative instruments currently used by the Company and discloses how these derivatives impact the Company's financial position and results of operations.

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Income Taxes

The provision for income taxes is based on amounts reported in the consolidated statements of income after exclusion of nontaxable income such as interest on state and municipal securities. Also, certain items of income and expenses are recognized in different time periods for financial statement purposes than for income tax purposes. Thus, provisions for deferred taxes are recorded in recognition of such temporary differences.

Deferred taxes are determined utilizing a liability method whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

The Company has adopted accounting guidance related to accounting for uncertainty in income taxes, which sets out a consistent framework to determine the appropriate level of tax reserves to maintain for uncertain tax positions.

The Company recognizes interest and penalties on income taxes as a component of income tax expense.

Revenue Recognition

The Company recognizes revenue in the consolidated statements of income as it is earned and when collectability is reasonably assured. The primary source of revenue is interest income from interest-earning assets, which is recognized on the accrual basis of accounting using the effective interest method. The recognition of revenues from interest-earning assets is based upon formulas from underlying loan agreements, securities contracts, or other similar contracts. Noninterest income is recognized on the accrual basis of accounting as services are provided or as transactions occur. Noninterest income includes fees from deposit accounts, merchant services, ATM and debit card fees, servicing fees, and other miscellaneous services and transactions.

Earnings Per Share

Basic earnings per share is calculated using the two-class method. The two-class method is an earnings allocation formula that determines earnings per share separately for common stock and participating securities according to dividends declared and participation rights in undistributed earnings. Under this method, all earnings distributed and undistributed, are allocated to participating securities and common shares based on their respective rights to receive dividends. Unvested share-based payment awards that contain nonforfeitable rights to dividends are considered participating securities (i.e. unvested time-vested restricted stock), not subject to performance based measures.

Basic earnings per share is calculated by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period. Diluted earnings per share is calculated in a manner similar to that of basic earnings per share except that the weighted average number of common shares outstanding is increased to include the number of additional common shares that would have been outstanding if all potentially dilutive common shares (such as those resulting from the exercise of stock options and warrants) were issued during the period, computed using the treasury stock method.

Statements of Cash Flows

For purposes of the statements of cash flows, cash and cash equivalents include cash and amounts due from banks and federal funds sold due to the short-term nature of these items.

Comprehensive Income

Comprehensive income includes net income and other comprehensive income or loss, which in the case of the Company includes unrealized gains and losses on securities and changes in the fair value of interest rate swaps, net of related income taxes.

Acquisition Accounting

Acquisitions are accounted for under the purchase method of accounting. Purchased assets and assumed liabilities are recorded at their respective acquisition date fair values, and identifiable intangible assets are recorded at fair value. If the consideration given exceeds the fair value of the net assets received, goodwill is recognized. If the fair value of the net assets received exceeds the consideration given, a bargain purchase gain is recognized. Fair values are subject to refinement for up to one year after the closing date of an acquisition as information relative to closing date fair values becomes available.

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Purchased loans acquired in a business combination are recorded at their estimated fair value as of the acquisition date. The fair value of loans acquired is determined using a discounted cash flow model based on assumptions regarding the amount and timing of principal and interest prepayments, estimated payments, estimated default rates, estimated loss severity in the event of defaults, and current market rates. The fair value adjustment for performing acquired loans is accreted over the life of the loan using the effective interest method. Estimated credit losses are included in the determination of fair value; therefore, an allowance for loan losses is not recorded on the acquisition date. Subsequent to acquisition, acquired performing loans are evaluated using a similar allowance methodology as the legacy portfolio. An allowance for credit losses is only recorded to the extent that the required reserves exceed the unaccreted fair value adjustment.

Acquired Impaired Loans

The Company accounts for acquired impaired loans under FASB ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (“ASC 310-30”). An acquired loan is considered impaired when there is evidence of credit deterioration since origination and it is probable at the date of acquisition that the Company will be unable to collect all contractually required payments. For acquired impaired loans, the Company (a) calculates the contractual amount and timing of undiscounted principal and interest payments (the “undiscounted contractual cash flows”) and (b) estimates the amount and timing of undiscounted expected principal and interest payments (the “undiscounted expected cash flows”). Under ASC 310-30, the difference between the undiscounted contractual cash flows and the undiscounted expected cash flows is the nonaccretable difference. The nonaccretable difference represents an estimate of the loss exposure of principal and interest related to the acquired impaired loan portfolio, and such amount is subject to change over time based on the performance of such loans.

The excess of expected cash flows at acquisition over the initial fair value of acquired impaired loans is referred to as the “accretable yield” and is recorded as interest income over the estimated life of the loans using the effective yield method if the timing and amount of the future cash flows is reasonably estimable. As required by ASC 310-30, the Company periodically re-estimates the expected cash flows to be collected over the life of the acquired impaired loans. Improvements in expected cash flows over those originally estimated increase the accretable yield and are recognized as interest income prospectively. Decreases in the amount and changes in the timing of expected cash flows compared to those originally estimated decrease the accretable yield and usually result in a provision for loan losses and the establishment of an allowance for loan losses with respect to the acquired impaired loan. The carrying value of acquired impaired loans is reduced by payments received, both principal and interest, and increased by the portion of the accretable yield recognized as interest income. If future cash flows are not reasonably estimable, the Company accounts for the acquired loans using the cash basis method.

Share Repurchases

Effective January 1, 2015, companies incorporated under Louisiana law became subject to the Louisiana Business Corporation Act. Provisions of the Louisiana Business Corporation Act eliminate the concept of treasury stock. Rather, shares purchased by the Company constitute authorized but unissued shares. Accounting principles generally accepted in the United States of America state that accounting for treasury stock shall conform to state law. The Company’s consolidated financial statements as of December 31, 2019, 2018 and 2017 reflect this change. The cost of shares purchased by the Company has been allocated to common stock and surplus balances.

Reclassifications

Certain reclassifications have been made to the 2018 and 2017 financial statements to conform to the 2019 presentation.

Tax Cuts and Jobs Act

Public law No. 115-97, known as the Tax Cuts and Jobs Act (the “TCJA”), enacted on December 22, 2017, reduced the U.S. federal corporate tax rate from 35% to 21% effective January 1, 2018. Also on December 22, 2017, the SEC issued Staff Accounting Bulletin No. 118 (“SAB 118”), which provided guidance on accounting for tax effects of the Tax Act. SAB 118 provided a measurement period of up to one year from the enactment date to complete the accounting. Any adjustments during this measurement period were to be included in net earnings from continuing operations as an adjustment to income tax expense in the reporting period when such adjustments were determined. Based on the information available and current interpretation of the rules, the Company recorded the impact of the reduction in the corporate tax rate and remeasurement of certain deferred tax assets and liabilities. The amount recorded in the fourth quarter of 2017 related to the remeasurement of the Company’s deferred tax balance resulted in additional income tax expense of \$0.3 million. An additional \$0.6 million was expensed in the first quarter of 2018 due to the remeasurement of the Company’s deferred tax balance. All necessary adjustments were recorded during the measurement period allowed by SAB 118.

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Impact of New Accounting Pronouncements

ASU 2016-01, Financial Instruments - Overall (Topic 825) became effective for the Company on January 1, 2018. This ASU makes targeted amendments to the guidance for recognition, measurement, presentation and disclosure of financial instruments. ASU 2016-01 requires equity investments, other than equity method investments, to be measured at fair value with changes in fair value recognized in net income. The ASU requires a cumulative-effect adjustment to retained earnings as of the beginning of the reporting period of adoption to reclassify the cumulative change in fair value of equity securities previously recognized in accumulated other comprehensive income (AOCI). The adoption of the guidance resulted in an insignificant cumulative-effect adjustment that decreased retained earnings, with offsetting related adjustments to deferred taxes and AOCI. The adoption of this ASU also resulted in equity securities previously classified as AFS securities to be classified as equity securities at fair value in the Company's December 31, 2018 consolidated balance sheet. ASU 2016-01 also emphasizes the existing requirement to use exit prices to measure fair value for disclosure purposes and clarifies that entities should not make use of a practicability exception in determining the fair value of loans. Accordingly, we refined the calculation used to determine the disclosed fair value of our loans held for investment portfolio as part of adopting this standard. The refined calculation did not have a significant impact on our fair value disclosures. See Note 18. Fair Values of Financial Instruments.

As a result of the adoption of ASU 2016-01, \$1.4 million of equity securities was reclassified from AFS securities to equity securities in the first quarter of 2018. At December 31, 2019 and 2018, equity securities include \$2.1 million and \$1.7 million, respectively, of exchange-traded equity securities that are measured at fair value with changes in fair value recognized in net income. The remaining balance of equity securities at December 31, 2019 and 2018 consists of stock in correspondent banks and is measured at cost, which approximates fair value, adjusted for any observable market transactions less any impairment. ASU 2016-01 also requires that other investments previously accounted for using the cost method be measured at fair value with changes in fair value recognized in net income. These investments, which had balances of \$1.4 million at both December 31, 2019 and 2018, are included in other assets in the consolidated balance sheet and represent investments in small business investment companies without readily determinable fair values. These investments are measured at fair value using the net asset value of the investment and any changes in fair value are recognized in net income.

ASU 2018-07, Compensation - Stock Compensation (Topic 718) was effective for the Company on January 1, 2019. ASU 2018-07 expands the scope of Topic 718 to include share-based payments issued to nonemployees for goods or services and supersedes Subtopic 505-50, "Equity - Equity-Based Payments to Non-Employees." The adoption of ASU 2018-07 did not have a material impact on the Company's consolidated financial statements.

ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities was effective for the Company on January 1, 2019. ASU 2017-12 amends the hedge accounting model in Topic 815 to enable entities to better portray the economics of their risk management activities in the financial statements and enhance the transparency and understandability of hedge results. The amendments expand an entity's ability to hedge nonfinancial and financial risk components and reduce complexity in fair value hedges of interest rate risk. The guidance eliminates the requirement to separately measure and report hedge ineffectiveness and generally requires the entire change in the fair value of a hedging instrument to be presented in the same income statement line as the hedged item. The guidance also eases certain documentation and assessment requirements and modifies the accounting for components excluded from the assessment of hedge effectiveness. Given the current level of derivatives designated as hedges, this ASU did not have a material impact on our consolidated financial statements.

ASU 2017-08, Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities, was effective for the Company on January 1, 2019. The amendments in the ASU shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

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ASU 2016-02, Leases (Topic 842) was effective for the Company on January 1, 2019. The ASU intends to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities and disclosing key information about leasing arrangements. The ASU requires lessees to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The new lease guidance simplifies the accounting for sale and leaseback transactions primarily because lessees must recognize lease assets and lease liabilities. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) may apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may also elect to apply the amendments in the ASU through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective.

The Company historically has owned all property and equipment, although it entered an operating lease for a future branch location on December 31, 2018. The Company adopted the ASU on January 1, 2019, using the modified retrospective approach, and recognized a right-of-use asset and related lease liability of \$1.2 million. During the year ended December 31, 2019, the Company acquired leases from Mainland and entered into a new lease for one of its de novo branches. At December 31, 2019, the right-of-use asset and related lease liability were \$3.3 million and \$3.4 million, respectively, and are recorded in Bank premises and equipment and Other liabilities on the consolidated balance sheet.

Recent Accounting Pronouncements

This section briefly describes accounting standards that have been issued, but are not yet adopted, that could impact the Company's financial statements.

FASB ASC Topic 250 "Intangibles - Goodwill and Other - Internal Use Software (Subtopic 250-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract" Update No. 2018-15. In August 2018, the FASB issued ASU 2018-15. This ASU requires an entity in a cloud computing arrangement (i.e., hosting arrangement) that is a service contract to follow the internal-use software guidance in ASC 350-40 to determine which implementation costs to capitalize as assets or expense as incurred. Capitalized implementation costs should be presented in the same line item on the balance sheet as amounts prepaid for the hosted service, if any (generally as an "other asset"). The capitalized costs will be amortized over the term of the hosting arrangement, with the amortization expense being presented in the same income statement line item as the fees paid for the hosted service. ASU 2018-15 is effective for the Company on January 1, 2020. Early adoption is permitted, including adoption in any interim period. The adoption of ASU 2018-15 is not expected to have a material impact on the Company's consolidated financial statements.

FASB ASC Topic 820 "Fair Value Measurement: Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement" Update No. 2018-13. In August 2018, the FASB issued ASU 2018-13, which modifies the disclosure requirements for fair value measurements by removing, modifying, or adding certain disclosures. ASU 2018-13 removes the disclosure requirement detailing the amount of and reasons for transfers between Level 1 and Level 2 and the valuation processes for Level 3 fair value measurements will be removed. In addition, this ASU modifies the disclosure requirement for investments in certain entities that calculate net asset value. Lastly, ASU 2018-13 adds a disclosure requirement for changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop Level 3 measurements. ASU 2018-13 is effective for the Company on January 1, 2020. The removed and modified disclosures will be adopted on a retrospective basis, and the new disclosures will be adopted on a prospective basis. The adoption of ASU 2018-13 is not expected to have a material impact on the Company's consolidated financial statements.

FASB ASC Topic 350 "Intangibles-Goodwill and Other: Simplifying the Test for Goodwill Impairment" ASU No. 2017-04. The FASB issued ASU No. 2017-04 in January 2017. This ASU simplifies how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Therefore, any carrying amount which exceeds the reporting unit's fair value, up to the amount of goodwill recorded, will be recognized as an impairment loss. ASU 2017-04 will be effective for the Company on January 1, 2020. The amendments will be applied prospectively on and after the effective date. Based on recent goodwill impairments tests, which did not require the application of Step 2, the Company does not expect the adoption of this ASU to have a material impact.

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FASB ASC Topic 326 “Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments” Update No. 2016-13. The FASB issued ASU No. 2016-13 in June 2016. The ASU requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. We are currently evaluating the potential impact of ASU 2016-13 on our financial statements. In that regard, we have formed a cross-functional working group, under the direction of our Chief Financial Officer and our Chief Risk Officer. The working group is comprised of individuals from various functional areas including credit, risk management, finance and information technology. We have developed an implementation plan to include assessment of processes, portfolio segmentation, model development, system requirements and the identification of data and resource needs, among other things. We have also selected a third-party vendor solution to assist us in the application of ASU 2016-13. The adoption of ASU 2016-13 is likely to result in an increase in the allowance for loan losses as a result of changing from an “incurred loss” model, which encompasses allowances for current known and inherent losses within the portfolio, to an “expected loss” model, which encompasses allowances for losses expected to be incurred over the life of the portfolio. Furthermore, ASU 2016-13 will necessitate that we establish an allowance for expected credit losses on debt securities. While we are currently unable to reasonably estimate the impact of adopting ASU 2016-13, we expect that the impact of adoption will be significantly influenced by the composition, characteristics and quality of our loan and securities portfolios, as well as the prevailing economic conditions and forecasts, as of the adoption date. This amendment was originally effective for the Company beginning January 1, 2020, including interim periods within those fiscal years. In July 2019, the FASB proposed changes that would delay the effective date for smaller reporting companies, as defined by the SEC, and other non-SEC reporting entities. In October 2019, the FASB voted in favor of finalizing its proposal to delay the effective date of this standard to fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. As a result, ASU 2016-13 will be effective for the Company on January 1, 2023. The Company expects to adopt the standard as soon as practicable, based upon progress on the implementation plan, as adoption prior to the revised effective date of January 1, 2023 is permitted by the ASU.

NOTE 2. BUSINESS COMBINATIONS

Mainland Bank

On March 1, 2019, the Company completed the acquisition of Mainland Bank (“Mainland”) located in Texas City, Texas. The Company acquired 100% of Mainland’s outstanding common shares for an aggregate merger consideration of 763,849 shares of the Company’s common stock, for a total of approximately \$18.6 million. The acquisition of Mainland expanded the Company’s branch footprint into the greater Houston, Texas market, and added \$128.4 million in total assets, \$82.4 million in loans, and \$107.6 million in deposits. As consideration paid was in excess of the net fair value of acquired assets, the Company recorded \$4.5 million of goodwill. There were certain adjustments to the initial calculation of goodwill during the open measurement period in 2019 which were not material. Goodwill resulted from a combination of synergies and cost savings, expansion into Texas with the addition of three branch locations, and enhanced products and services.

The table below shows the allocation of the consideration paid for Mainland’s common equity to the acquired identifiable assets and liabilities assumed and the goodwill generated from the transaction (dollars in thousands). The fair values listed below, primarily related to loans and deferred tax assets and liabilities, are subject to refinement for up to one year after the closing date of the acquisition as additional information becomes available.

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Purchase price:		
Stock issued	\$	18,637
Fair value of assets acquired:		
Cash and cash equivalents		38,365
Loans		82,431
Other real estate owned		1,507
Bank premises and equipment		2,550
Core deposit intangible asset		2,439
Other assets		1,081
Total assets acquired		128,373
Fair value of liabilities acquired:		
Deposits		107,646
Repurchase agreements		4,684
Other liabilities		1,883
Total liabilities assumed		114,213
Fair value of net assets acquired		14,160
Goodwill	\$	4,477

Fair value adjustments to assets acquired and liabilities assumed are generally amortized using the effective yield method over periods consistent with the average life, useful life and/or contractual term of the related assets and liabilities.

The fair value of net assets acquired includes a fair value adjustment to loans as of the acquisition date. The adjustment for the acquired loan portfolio is based on current market interest rates, and the Company's initial evaluation of credit losses identified. No loans acquired from Mainland were considered to be purchased credit impaired loans. The contractually required principal and interest payments of the loans acquired from Mainland are \$91.9 million, of which \$1.3 million is not expected to be collected.

Bank of York

On November 1, 2019, the Company completed the acquisition of Bank of York located in York, Alabama. The Company acquired 100% of Bank of York's outstanding common shares for an aggregate merger consideration of \$15.0 million. The acquisition of Bank of York expanded the Company's branch footprint into the west Alabama market. The acquisition added \$102.0 million in total assets, \$46.1 million in loans, and \$85.0 million in deposits. As consideration paid was in excess of the net fair value of acquired assets, the Company recorded \$4.2 million of goodwill. Goodwill resulted from a combination of synergies and cost savings, and expansion into Alabama with the addition of two branch locations.

The table below shows the allocation of the consideration paid for Bank of York's common equity to the acquired identifiable assets and liabilities assumed and the goodwill generated from the transaction (dollars in thousands). The fair values listed below, primarily related to loans and deferred tax assets and liabilities, are subject to refinement for up to one year after the closing date of the acquisition as additional information becomes available.

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Purchase price:		
Cash paid	\$	15,000
Fair value of assets acquired:		
Cash and cash equivalents		50,771
Investments		451
Loans		46,127
Bank premises and equipment		917
Core deposit intangible asset		931
Bank owned life insurance		2,429
Other assets		351
Total assets acquired		101,977
Fair value of liabilities acquired:		
Deposits		85,004
Repurchase agreements		5,641
Other liabilities		562
Total liabilities assumed		91,207
Fair value of net assets acquired		10,770
Goodwill	\$	4,230

The fair value of net assets acquired includes a fair value adjustment to loans as of the acquisition date. The adjustment for the acquired loan portfolio is based on current market interest rates, and the Company's initial evaluation of credit losses identified. The total contractually required principal and interest payments of the loans acquired from Bank of York are \$51.5 million, of which \$0.9 million is not expected to be collected.

Loans acquired from Bank of York that are considered to be purchased credit impaired loans had a balance of \$0.3 million. The total contractually required principal and interest payments of these loans are \$0.3 million, of which \$0.1 million is not expected to be collected.

The change in goodwill and other intangibles at December 31, 2019 compared to December 31, 2018 is primarily attributable to the goodwill and core deposit intangibles recorded as a result of the Mainland and Bank of York acquisitions.

Acquisition Expense

Acquisition related costs of \$2.1 million and \$1.4 million are included in acquisition expenses in the accompanying consolidated statements of income for the years ended December 31, 2019 and 2018, respectively. These costs include system conversion and integrating operations charges for Mainland and legal and consulting expenses related to the acquisitions of Mainland and Bank of York, as well as the system conversion and integrating operations charges for the acquisition of BOJ Bancshares, Inc. which closed on December 1, 2017.

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NOTE 3. INVESTMENT SECURITIES

The amortized cost and approximate fair value of investment securities classified as AFS are summarized below as of the dates presented (dollars in thousands).

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2019				
Obligations of U.S. government agencies and corporations	\$ 33,651	\$ 100	\$ (100)	\$ 33,651
Obligations of state and political subdivisions	32,920	541	(12)	33,449
Corporate bonds	19,245	192	(274)	19,163
Residential mortgage-backed securities	100,948	1,083	(85)	101,946
Commercial mortgage-backed securities	71,340	564	(308)	71,596
Total	<u>\$ 258,104</u>	<u>\$ 2,480</u>	<u>\$ (779)</u>	<u>\$ 259,805</u>

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2018				
Obligations of U.S. government agencies and corporations	\$ 7,946	\$ 14	\$ (90)	\$ 7,870
Obligations of state and political subdivisions	34,875	6	(895)	33,986
Corporate bonds	16,166	53	(710)	15,509
Residential mortgage-backed securities	136,768	336	(2,177)	134,927
Commercial mortgage-backed securities	57,749	108	(1,168)	56,689
Total	<u>\$ 253,504</u>	<u>\$ 517</u>	<u>\$ (5,040)</u>	<u>\$ 248,981</u>

Proceeds from sales of investment securities AFS and gross realized gains and losses are summarized below as of the dates presented (dollars in thousands).

	Twelve months ended December 31,		
	2019	2018	2017
Proceeds from sale	\$ 65,834	\$ 7,021	\$ 106,448
Gross gains	\$ 608	\$ 35	\$ 342
Gross losses	\$ (346)	\$ (21)	\$ (50)

The amortized cost and approximate fair value of investment securities classified as HTM are summarized below as of the dates presented (dollars in thousands).

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2019				
Obligations of state and political subdivisions	\$ 9,487	\$ 14	\$ —	\$ 9,501
Residential mortgage-backed securities	4,922	57	—	4,979
Total	<u>\$ 14,409</u>	<u>\$ 71</u>	<u>\$ —</u>	<u>\$ 14,480</u>

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2018				
Obligations of state and political subdivisions	\$ 10,699	\$ 2	\$ (111)	\$ 10,590
Residential mortgage-backed securities	5,367	—	(152)	5,215
Total	<u>\$ 16,066</u>	<u>\$ 2</u>	<u>\$ (263)</u>	<u>\$ 15,805</u>

The number of AFS securities, fair value, and unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are summarized below as of the dates presented (dollars in thousands).

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	Count	Less than 12 Months		12 Months or More		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2019							
Obligations of U.S. government agencies and corporations	21	\$ 19,980	\$ (94)	\$ 955	\$ (6)	\$ 20,935	\$ (100)
Obligations of state and political subdivisions	10	212	(1)	371	(11)	583	(12)
Corporate bonds	21	495	(5)	7,829	(269)	8,324	(274)
Residential mortgage-backed securities	32	12,341	(56)	6,190	(29)	18,531	(85)
Commercial mortgage-backed securities	57	29,072	(274)	2,516	(34)	31,588	(308)
Total	141	\$ 62,100	\$ (430)	\$ 17,861	\$ (349)	\$ 79,961	\$ (779)

	Count	Less than 12 Months		12 Months or More		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2018							
Obligations of U.S. government agencies and corporations	15	\$ 469	\$ —	\$ 5,304	\$ (90)	\$ 5,773	\$ (90)
Obligations of state and political subdivisions	63	13,716	(330)	19,270	(565)	32,986	(895)
Corporate bonds	27	6,793	(225)	5,763	(485)	12,556	(710)
Residential mortgage-backed securities	193	24,868	(245)	79,517	(1,932)	104,385	(2,177)
Commercial mortgage-backed securities	94	5,156	(42)	39,560	(1,126)	44,716	(1,168)
Total	392	\$ 51,002	\$ (842)	\$ 149,414	\$ (4,198)	\$ 200,416	\$ (5,040)

The number of HTM securities, fair value, and unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are summarized below as of the dates presented (dollars in thousands).

	Count	Less than 12 Months		12 Months or More		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2019							
Obligations of state and political subdivisions	—	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Residential mortgage-backed securities	—	—	—	—	—	—	—
Total	—	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —

	Count	Less than 12 Months		12 Months or More		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2018							
Obligations of state and political subdivisions	1	\$ —	\$ —	\$ 5,468	\$ (111)	\$ 5,468	\$ (111)
Residential mortgage-backed securities	9	1,761	(35)	3,454	(117)	5,215	(152)
Total	10	\$ 1,761	\$ (35)	\$ 8,922	\$ (228)	\$ 10,683	\$ (263)

The unrealized losses in the Bank's investment portfolio, caused by interest rate increases, are not credit issues. The Bank does not intend to sell the securities and it is not more likely than not that the Bank will be required to sell the investments before recovery of their amortized cost bases. The Bank does not consider these securities to be other-than-temporarily impaired at December 31, 2019 or December 31, 2018.

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The amortized cost and approximate fair value of investment debt securities, by contractual maturity (including mortgage-backed securities), are shown below as of the dates presented (dollars in thousands). Actual 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 Available For Sale		Securities Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
December 31, 2019				
Due within one year	\$ 2,174	\$ 2,175	\$ 790	\$ 792
Due after one year through five years	13,525	13,675	3,575	3,582
Due after five years through ten years	66,551	66,568	5,122	5,126
Due after ten years	175,854	177,387	4,922	4,980
Total debt securities	\$ 258,104	\$ 259,805	\$ 14,409	\$ 14,480

	Securities Available For Sale		Securities Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
December 31, 2018				
Due within one year	\$ 3,734	\$ 3,730	\$ 755	\$ 755
Due after one year through five years	10,681	10,600	3,405	3,406
Due after five years through ten years	44,255	43,460	960	961
Due after ten years	194,834	191,191	10,946	10,683
Total debt securities	\$ 253,504	\$ 248,981	\$ 16,066	\$ 15,805

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES

The Company's loan portfolio consists of the following categories of loans as of the dates presented (dollars in thousands).

	December 31,	
	2019	2018
Construction and development	\$ 197,797	\$ 157,946
1-4 Family	321,489	287,137
Multifamily	60,617	50,501
Farmland	27,780	21,356
Commercial real estate	731,060	627,004
Total mortgage loans on real estate	1,338,743	1,143,944
Commercial and industrial	323,786	210,924
Consumer	29,446	45,957
Total loans	\$ 1,691,975	\$ 1,400,825

Unamortized premiums and discounts on loans, included in the total loans balances above, were \$2.1 million and \$1.4 million at December 31, 2019 and 2018, respectively and unearned income on loans was \$0.9 million and \$0.5 million at December 31, 2019 and 2018, respectively.

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Nonaccrual and Past Due Loans

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on nonaccrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. In determining whether or not a borrower may be unable to meet payment obligations for each class of loans, we consider the borrower's debt service capacity through the analysis of current financial information, if available, and/or current information with regard to our collateral position. Regulatory provisions would typically require the placement of a loan on nonaccrual status if (i) principal or interest has been in default for a period of 90 days or more unless the loan is both well secured and in the process of collection or (ii) full payment of principal and interest is not expected. Loans may be placed on nonaccrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income on nonaccrual loans is recognized only to the extent that cash payments are received in excess of principal due. A loan may be returned to accrual status when all the principal and interest amounts contractually due are brought current and future payment of principal and interest amounts contractually due are reasonably assured, which is typically evidenced by a sustained period (at least six months) of repayment performance by the borrower.

The tables below provide an analysis of the aging of loans as of the dates presented (dollars in thousands).

December 31, 2019								
	Accruing				Nonaccrual	Total Past Due & Nonaccrual	Acquired Impaired Loans	Total Loans
	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due				
Construction and development	\$ 197,318	\$ 133	\$ 32	\$ —	\$ 314	\$ 479	\$ —	\$ 197,797
1-4 Family	317,572	998	413	138	1,923	3,472	445	321,489
Multifamily	60,617	—	—	—	—	—	—	60,617
Farmland	25,516	—	—	—	—	—	2,264	27,780
Commercial real estate	727,423	1,193	14	657	141	2,005	1,632	731,060
Total mortgage loans on real estate	1,328,446	2,324	459	795	2,378	5,956	4,341	1,338,743
Commercial and industrial	323,446	171	19	—	137	327	13	323,786
Consumer	28,443	339	95	—	531	965	38	29,446
Total loans	\$ 1,680,335	\$ 2,834	\$ 573	\$ 795	\$ 3,046	\$ 7,248	\$ 4,392	\$ 1,691,975

December 31, 2018								
	Accruing				Nonaccrual	Total Past Due & Nonaccrual	Acquired Impaired Loans	Total Loans
	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due				
Construction and development	\$ 157,202	\$ 175	\$ —	\$ —	\$ 556	\$ 731	\$ 13	\$ 157,946
1-4 Family	284,205	1,101	41	—	1,300	2,442	490	287,137
Multifamily	50,392	109	—	—	—	109	—	50,501
Farmland	19,092	—	—	—	—	—	2,264	21,356
Commercial real estate	624,244	66	—	—	683	749	2,011	627,004
Total mortgage loans on real estate	1,135,135	1,451	41	—	2,539	4,031	4,778	1,143,944
Commercial and industrial	209,399	221	45	—	64	330	1,195	210,924
Consumer	44,493	375	51	—	994	1,420	44	45,957
Total loans	\$ 1,389,027	\$ 2,047	\$ 137	\$ —	\$ 3,597	\$ 5,781	\$ 6,017	\$ 1,400,825

Portfolio Segment Risk Factors

The following describes the risk characteristics relevant to each of the Company's loan portfolio segments.

Construction and Development. Construction and development loans are generally made for the purpose of acquisition and development of land to be improved through the construction of commercial and residential buildings. The successful repayment of these types of loans is generally dependent upon a commitment for permanent financing from the Company, or from the sale of the constructed property. These loans carry more risk than commercial or residential real estate loans due to the dynamics of construction projects, changes in interest rates, the long-term financing market, and state and local government regulations. One such risk is that loan funds are advanced upon the security of the property under construction, which is of uncertain value prior to the completion of construction. Thus, it is more difficult to evaluate accurately the total loan funds required to complete a project and to calculate related loan-to-value ratios. The Company attempts to minimize the risks associated with construction lending by limiting loan-to-value ratios as described above. In addition, as to speculative development loans, the Company generally makes such loans only to borrowers that have a positive pre-existing relationship with us. The Company manages risk by using specific underwriting policies and procedures for these types of loans and by avoiding excessive concentrations in any one business or industry.

1-4 Family. The 1-4 Family portfolio mainly consists of residential mortgage loans to consumers to finance a primary residence. The majority of these loans are secured by properties located in the Company's market areas and carry risks associated with the creditworthiness of the borrower and changes in the value of the collateral and loan-to-value-ratios. The Company manages these risks through policies and procedures such as limiting loan-to-value ratios at origination, employing experienced underwriting personnel, requiring standards for appraisers, and not making subprime loans.

Multifamily. Multifamily loans are normally made to real estate investors to support permanent financing for multifamily residential income producing properties that rely on the successful operation of the property for repayment. This management mainly involves property maintenance and collection of rents due from tenants. This type of lending carries a lower level of risk, as compared to other commercial lending. In addition, underwriting requirements for multifamily properties are stricter than for other non-owner-occupied property types. The Company manages this risk by avoiding concentrations with any particular customer.

Farmland. Farmland loans are often for land improvements related to agricultural endeavors and may include construction of new specialized facilities. These loans are usually repaid through the conversion to permanent financing, or if scheduled loan amortization begins, for the long-term benefit of the borrower's ongoing operations. Underwriting generally involves intensive analysis of the financial strength of the borrower and guarantor, liquidation value of the subject collateral, the associated unguaranteed exposure, and any available secondary sources of repayment, with the greatest emphasis given to a borrower's capacity to meet cash flow coverage requirements as set forth by Bank policies.

Commercial Real Estate. Commercial real estate loans are extensions of credit secured by owner occupied and non-owner occupied collateral. Underwriting generally involves intensive analysis of the financial strength of the borrower and guarantor, liquidation value of the subject collateral, the associated unguaranteed exposure, and any available secondary sources of repayment, with the greatest emphasis given to a borrower's capacity to meet cash flow coverage requirements as set forth by Bank policies. Repayment is commonly derived from the successful ongoing operations of the property. General market conditions and economic activity may impact the performance of these types of loans, including fluctuations in the value of real estate, new job creation trends, and tenant vacancy rates. The Company attempts to limit risk by analyzing a borrower's cash flow and collateral value on an ongoing basis. The Company also typically requires personal guarantees from the principal owners of the property, supported by a review of their personal financial statements, as an additional means of mitigating our risk. The Company manages risk by avoiding concentrations in any one business or industry.

Commercial and Industrial. Commercial and industrial loans receive similar underwriting treatment as commercial real estate loans in that the repayment source is analyzed to determine its ability to meet cash flow coverage requirements as set forth by Bank policies. Repayment of these loans generally comes from the generation of cash flow as the result of the borrower's business operations. Commercial lending generally involves different risks from those associated with commercial real estate lending or construction lending. Although commercial loans may be collateralized by equipment or other business assets (including real estate, if available as collateral), the repayment of these types of loans depends primarily on the creditworthiness and projected cash flow of the borrower (and any guarantors). Thus, the general business conditions of the local economy and the borrower's ability to sell its products and services, thereby generating sufficient operating revenue to repay us under the agreed upon terms and conditions, are the chief considerations when assessing the risk of a commercial loan. The liquidation of collateral, if any, is considered a secondary source of repayment because equipment and other business assets may, among other things, be obsolete or of limited resale value. The Company actively monitors certain financial measures of the borrower, including advance rate, cash flow, collateral value and other appropriate credit factors.

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Consumer. Consumer loans are offered by the Company in order to provide a full range of retail financial services to its customers and include auto loans, credit cards, and other consumer installment loans. Typically, the Company evaluates the borrower's repayment ability through a review of credit scores and an evaluation of debt to income ratios. Repayment of consumer loans depends upon key consumer economic measures and upon the borrower's financial stability, and is more likely to be adversely affected by divorce, job loss, illness and personal hardships than repayment of other loans. A shortfall in the value of any collateral also may pose a risk of loss to the Company for these types of loans. Indirect auto loans comprised the largest component of our consumer loans, representing 44% of our total consumer loans at December 31, 2019. At December 31, 2019, the weighted average remaining term of the indirect auto loan portfolio was 2 years. We exited the indirect auto lending business at the end of 2015.

Credit Quality Indicators

Loans are categorized into risk categories based on relevant information about the ability of borrowers to service their debt, such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The following definitions are utilized for risk ratings, which are consistent with the definitions used in supervisory guidance.

Pass – Loans not meeting the criteria below are considered pass. These loans have high credit characteristics and financial strength. The borrowers at least generate profits and cash flow that are in line with peer and industry standards and have debt service coverage ratios above loan covenants and our policy guidelines. For some of these loans, a guaranty from a financially capable party mitigates characteristics of the borrower that might otherwise result in a lower grade.

Special Mention – Loans classified as special mention possess some credit deficiencies that need to be corrected to avoid a greater risk of default in the future. For example, financial ratios relating to the borrower may have deteriorated. Often, a special mention categorization is temporary while certain factors are analyzed or matters addressed before the loan is re-categorized as either pass or substandard.

Substandard – Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the borrower or the liquidation value of any collateral. If deficiencies are not addressed, it is likely that this category of loan will result in the Bank incurring a loss. Where a borrower has been unable to adjust to industry or general economic conditions, the borrower's loan is often categorized as substandard.

Doubtful – Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loss – Loans classified as loss are considered uncollectible and of such little value that their continuance as recorded assets is not warranted. This classification does not mean that the assets have absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off these assets.

The tables below present a summary of the Company's loan portfolio by category and credit quality indicator as of the dates presented (dollars in thousands).

	December 31, 2019				
	Pass	Special Mention	Substandard	Doubtful	Total
Construction and development	\$ 196,873	\$ 610	\$ 314	\$ —	\$ 197,797
1-4 Family	318,549	714	2,198	28	321,489
Multifamily	60,617	—	—	—	60,617
Farmland	25,516	—	2,264	—	27,780
Commercial real estate	729,921	—	1,139	—	731,060
Total mortgage loans on real estate	1,331,476	1,324	5,915	28	1,338,743
Commercial and industrial	318,519	2,910	2,264	93	323,786
Consumer	28,775	128	543	—	29,446
Total loans	\$ 1,678,770	\$ 4,362	\$ 8,722	\$ 121	\$ 1,691,975

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	December 31, 2018				
	Pass	Special Mention	Substandard	Doubtful	Total
Construction and development	\$ 157,360	\$ —	\$ 586	\$ —	\$ 157,946
1-4 Family	285,692	69	1,303	73	287,137
Multifamily	50,501	—	—	—	50,501
Farmland	19,092	—	2,264	—	21,356
Commercial real estate	625,670	—	1,334	—	627,004
Total mortgage loans on real estate	1,138,315	69	5,487	73	1,143,944
Commercial and industrial	207,941	—	2,983	—	210,924
Consumer	44,798	167	992	—	45,957
Total loans	\$ 1,391,054	\$ 236	\$ 9,462	\$ 73	\$ 1,400,825

The Company had no loans that were classified as loss at December 31, 2019 or 2018.

Loan participations and whole loans sold to and serviced for others are not included in the accompanying consolidated balance sheets. The balances of the participations and whole loans sold were \$82.8 million and \$135.4 million as of December 31, 2019 and 2018, respectively. The unpaid principal balances of these loans were approximately \$174.7 million and \$187.6 million at December 31, 2019 and 2018, respectively.

In the ordinary course of business, the Company makes loans to related parties including its executive officers, principal shareholders, directors and their immediate family members, as well as to companies in which these individuals are principal owners. Loans outstanding to such related party borrowers amounted to approximately \$98.1 million and \$93.0 million as of December 31, 2019 and December 31, 2018, respectively.

The table below shows the aggregate principal balance of loans to such related parties for the years ended December 31, 2019 and 2018 (dollars in thousands).

	December 31,	
	2019	2018
Balance, beginning of period	\$ 93,021	\$ 31,153
New loans/changes in relationship	20,903	79,639
Repayments/changes in relationship	(15,831)	(17,771)
Balance, end of period	\$ 98,093	\$ 93,021

During the year ended December 31, 2018, a company of which a director is the principal owner purchased a \$0.7 million substandard loan from the Bank for \$0.7 million. The substandard loan was made to a related party of the director. The Company did not record a gain or loss on the sale of the loan because the proceeds approximated the Bank's recorded investment.

Loans Acquired with Deteriorated Credit Quality

The Company accounts for certain loans acquired as acquired impaired loans under ASC 310-30 due to evidence of credit deterioration at acquisition and the probability that the Company will be unable to collect all contractually required payments.

There were no changes in the accretable yield on acquired impaired loans for the years ended December 31, 2019 and 2018.

Allowance for Loan Losses

The table below shows a summary of the activity in the allowance for loan losses for the years ended December 31, 2019, 2018 and 2017 (dollars in thousands).

	December 31,		
	2019	2018	2017
Balance, beginning of period	\$ 9,454	\$ 7,891	\$ 7,051
Provision for loan losses	1,908	2,570	1,540
Loans charged-off	(800)	(1,185)	(765)
Recoveries	138	178	65
Balance, end of period	\$ 10,700	\$ 9,454	\$ 7,891

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The following tables outline the activity in the allowance for loan losses by collateral type for the years ended December 31, 2019, 2018 and 2017, and show both the allowance and portfolio balances for loans individually and collectively evaluated for impairment as of December 31, 2019, 2018 and 2017 (dollars in thousands).

	December 31, 2019							
	Construction & Development	Farmland	1-4 Family	Multifamily	Commercial Real Estate	Commercial & Industrial	Consumer	Total
Allowance for loan losses:								
Beginning balance	\$ 1,038	\$ 81	\$ 1,465	\$ 331	\$ 4,182	\$ 1,641	\$ 716	\$ 9,454
Charge-offs	(51)	—	(62)	—	(24)	(252)	(411)	(800)
Recoveries	27	—	27	—	1	26	57	138
Provision	187	20	60	56	265	1,194	126	1,908
Ending balance	<u>\$ 1,201</u>	<u>\$ 101</u>	<u>\$ 1,490</u>	<u>\$ 387</u>	<u>\$ 4,424</u>	<u>\$ 2,609</u>	<u>\$ 488</u>	<u>\$ 10,700</u>
Ending allowance balance for loans individually evaluated for impairment	—	—	—	—	—	—	141	141
Ending allowance balance for loans acquired with deteriorated credit quality	—	—	—	—	—	—	—	—
Ending allowance balance for loans collectively evaluated for impairment	1,201	101	1,490	387	4,424	2,609	347	10,559
Loans receivable:								
Balance of loans individually evaluated for impairment	247	—	1,662	—	47	93	498	2,547
Balance of loans acquired with deteriorated credit quality	—	2,264	445	—	1,632	13	38	4,392
Balance of loans collectively evaluated for impairment	197,550	25,516	319,382	60,617	729,381	323,680	28,910	1,685,036
Total period-end balance	<u>\$ 197,797</u>	<u>\$ 27,780</u>	<u>\$ 321,489</u>	<u>\$ 60,617</u>	<u>\$ 731,060</u>	<u>\$ 323,786</u>	<u>\$ 29,446</u>	<u>\$ 1,691,975</u>

	December 31, 2018							
	Construction & Development	Farmland	1-4 Family	Multifamily	Commercial Real Estate	Commercial & Industrial	Consumer	Total
Allowance for loan losses:								
Beginning balance	\$ 945	\$ 60	\$ 1,287	\$ 332	\$ 3,599	\$ 693	\$ 975	\$ 7,891
Charge-offs	(24)	—	(167)	—	—	(481)	(513)	(1,185)
Recoveries	12	—	29	—	—	55	82	178
Provision	105	21	316	(1)	583	1,374	172	2,570
Ending balance	<u>\$ 1,038</u>	<u>\$ 81</u>	<u>\$ 1,465</u>	<u>\$ 331</u>	<u>\$ 4,182</u>	<u>\$ 1,641</u>	<u>\$ 716</u>	<u>\$ 9,454</u>
Ending allowance balance for loans individually evaluated for impairment	—	—	—	—	—	—	236	236
Ending allowance balance for loans acquired with deteriorated credit quality	—	—	—	—	—	—	—	—
Ending allowance balance for loans collectively evaluated for impairment	1,038	81	1,465	331	4,182	1,641	480	9,218
Loans receivable:								
Balance of loans individually evaluated for impairment	339	—	1,177	—	761	76	916	3,269
Balance of loans acquired with deteriorated credit quality	13	2,264	490	—	2,011	1,195	44	6,017
Balance of loans collectively evaluated for impairment	157,594	19,092	285,470	50,501	624,232	209,653	44,997	1,391,539
Total period-end balance	<u>\$ 157,946</u>	<u>\$ 21,356</u>	<u>\$ 287,137</u>	<u>\$ 50,501</u>	<u>\$ 627,004</u>	<u>\$ 210,924</u>	<u>\$ 45,957</u>	<u>\$ 1,400,825</u>

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December 31, 2017

	Construction & Development	Farmland	1-4 Family	Multifamily	Commercial Real Estate	Commercial & Industrial	Consumer	Total
Allowance for loan losses:								
Beginning balance	\$ 579	\$ 60	\$ 1,377	\$ 355	\$ 2,499	\$ 759	\$ 1,422	\$ 7,051
Charge-offs	—	—	—	—	—	(270)	(495)	(765)
Recoveries	34	—	7	—	—	—	24	65
Provision	332	—	(97)	(23)	1,100	204	24	1,540
Ending balance	<u>\$ 945</u>	<u>\$ 60</u>	<u>\$ 1,287</u>	<u>\$ 332</u>	<u>\$ 3,599</u>	<u>\$ 693</u>	<u>\$ 975</u>	<u>\$ 7,891</u>
Ending allowance balance for loans individually evaluated for impairment	—	—	—	—	—	—	304	304
Ending allowance balance for loans acquired with deteriorated credit quality	—	—	—	—	—	—	—	—
Ending allowance balance for loans collectively evaluated for impairment	945	60	1,287	332	3,599	693	671	7,587
Loans receivable:								
Balance of loans individually evaluated for impairment	182	—	1,136	—	640	—	1,086	3,044
Balance of loans acquired with deteriorated credit quality	285	4,161	1,486	1,012	2,087	1,329	4	10,364
Balance of loans collectively evaluated for impairment	157,200	19,677	274,300	50,271	534,637	134,063	75,223	1,245,371
Total period-end balance	<u>\$ 157,667</u>	<u>\$ 23,838</u>	<u>\$ 276,922</u>	<u>\$ 51,283</u>	<u>\$ 537,364</u>	<u>\$ 135,392</u>	<u>\$ 76,313</u>	<u>\$ 1,258,779</u>

Impaired Loans

The Company considers a loan to be impaired when, based on current information and events, the Company determines that it will not be able to collect all amounts due according to the loan agreement, including scheduled interest payments. Determination of impairment is treated the same across all classes of loans. When the Company identifies a loan as impaired, it measures the impairment based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole (remaining) source of repayment for the loans is the operation or liquidation of the collateral. In these cases when foreclosure is probable, the Company uses the current fair value of the collateral, less selling costs, instead of discounted cash flows. If the Company determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs, and unamortized premium or discount), the Company recognizes impairment through an allowance estimate or a charge-off to the allowance.

When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is on nonaccrual, all payments are applied to principal, under the cost recovery method. When the ultimate collectability of the total principal of an impaired loan is not in doubt and the loan is on nonaccrual, contractual interest is credited to interest income when received, under the cash basis method.

The following tables contain information on the Company's impaired loans, which include troubled debt restructurings ("TDR"), discussed in more detail below, and nonaccrual loans individually evaluated for impairment for purposes of determining the allowance for loan losses. The average balances are calculated based on the month-end balances of the loans during the period reported (dollars in thousands).

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As of and for the year ended December 31, 2019

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
<u>With no related allowance recorded:</u>					
Construction and development	\$ 247	\$ 269	\$ —	\$ 328	\$ 14
1-4 Family	1,662	1,745	—	1,507	32
Multifamily	—	—	—	36	—
Commercial real estate	47	50	—	700	7
Total mortgage loans on real estate	1,956	2,064	—	2,571	53
Commercial and industrial	93	96	—	33	—
Consumer	188	205	—	328	—
Total	2,237	2,365	—	2,932	53
<u>With related allowance recorded:</u>					
Consumer	310	347	141	324	—
Total	310	347	141	324	—
<u>Total loans:</u>					
Construction and development	247	269	—	328	14
1-4 Family	1,662	1,745	—	1,507	32
Multifamily	—	—	—	36	—
Commercial real estate	47	50	—	700	7
Total mortgage loans on real estate	1,956	2,064	—	2,571	53
Commercial and industrial	93	96	—	33	—
Consumer	498	552	141	652	—
Total	\$ 2,547	\$ 2,712	\$ 141	\$ 3,256	\$ 53

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As of and for the year ended December 31, 2018

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Construction and development	\$ 339	\$ 359	\$ —	\$ 237	\$ 13
1-4 Family	1,177	1,180	—	1,455	39
Commercial real estate	761	777	—	878	20
Total mortgage loans on real estate	2,277	2,316	—	2,570	72
Commercial and industrial	76	77	—	278	—
Consumer	215	237	—	410	—
Total	2,568	2,630	—	3,258	72
With related allowance recorded:					
Consumer	701	738	236	588	—
Total	701	738	236	588	—
Total loans:					
Construction and development	339	359	—	237	13
1-4 Family	1,177	1,180	—	1,455	39
Commercial real estate	761	777	—	878	20
Total mortgage loans on real estate	2,277	2,316	—	2,570	72
Commercial and industrial	76	77	—	278	—
Consumer	916	975	236	998	—
Total	\$ 3,269	\$ 3,368	\$ 236	\$ 3,846	\$ 72

As of and for the year ended December 31, 2017

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Construction and development	\$ 182	\$ 202	\$ —	\$ 338	\$ 13
1-4 Family	1,136	1,169	—	1,344	76
Commercial real estate	640	654	—	620	46
Total mortgage loans on real estate	1,958	2,025	—	2,302	135
Commercial and industrial	—	—	—	122	—
Consumer	168	217	—	380	1
Total	2,126	2,242	—	2,804	136
With related allowance recorded:					
Consumer	918	956	304	738	1
Total	918	956	304	738	1
Total loans:					
Construction and development	182	202	—	338	13
1-4 Family	1,136	1,169	—	1,344	76
Commercial real estate	640	654	—	620	46
Total mortgage loans on real estate	1,958	2,025	—	2,302	135
Commercial and industrial	—	—	—	122	—
Consumer	1,086	1,173	304	1,118	2
Total	\$ 3,044	\$ 3,198	\$ 304	\$ 3,542	\$ 137

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Troubled Debt Restructurings

In situations where, for economic or legal reasons related to a borrower's financial difficulties, the Company grants a concession for other than an insignificant period of time to the borrower that the Company would not otherwise consider, the related loan is classified as a TDR. The Company strives to identify borrowers in financial difficulty early and work with them to modify their loans to more affordable terms before such loans reach nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases in which the Company grants the borrower new terms that provide for a reduction of either interest or principal, or otherwise include a concession, the Company identifies the loan as a TDR and measures any impairment on the restructuring as previously noted for impaired loans.

Loans classified as TDRs, consisting of 18 credits, totaled approximately \$1.5 million at December 31, 2019, compared to 24 credits totaling \$2.2 million at December 31, 2018. Ten of the restructured loans were considered TDRs due to modification of terms through adjustments to maturity, seven of the restructured loans were considered TDRs due to a reduction in the interest rate to a rate lower than the current market rate, and one restructured loan was considered a TDR due to forgiveness of interest due on the loan. At December 31, 2019, two of the TDRs were in default of their modified terms and are included in nonaccrual loans. At December 31, 2018, three of the TDRs were in default of their modified terms and were included included in nonaccrual loans. The Company individually evaluates each TDR for allowance purposes, primarily based on collateral value, and excludes these loans from the loan population that is collectively evaluated for impairment (ASC 450).

At December 31, 2019 and 2018, there were no available balances on loans classified as TDRs that the Company was committed to lend.

The table below presents the TDR pre- and post-modification outstanding recorded investments by loan categories for loans modified during the years ended December 31, 2019 and 2018 (dollars in thousands).

	December 31, 2019			December 31, 2018		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings						
Construction and development	—	\$ —	\$ —	2	\$ 403	\$ 403
1-4 Family	—	—	—	8	587	587
Commercial and industrial	—	—	—	2	12	12
		\$ —	\$ —		\$ 1,002	\$ 1,002

There were no loans modified under troubled debt restructurings during the previous twelve month period that subsequently defaulted during the year ended December 31, 2019.

The following is a summary of accruing and nonaccrual TDRs and the related loan losses by portfolio type as of the dates presented (dollars in thousands).

	TDRs			Related Allowance
	Accruing	Nonaccrual	Total	
December 31, 2019				
Construction and development	\$ 220	\$ 287	\$ 507	\$ —
1-4 Family	800	176	976	—
Total	\$ 1,020	\$ 463	\$ 1,483	\$ —
December 31, 2018				
Construction and development	\$ 239	\$ 284	\$ 523	\$ —
1-4 Family	919	190	1,109	—
Commercial real estate	78	468	546	—
Commercial and industrial	12	—	12	—
Total	\$ 1,248	\$ 942	\$ 2,190	\$ —

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The table below includes the average recorded investment and interest income recognized for TDRs for the years ended December 31, 2019, 2018 and 2017 (dollars in thousands).

	TDRs	
	Average Recorded Investment	Interest Income Recognized
December 31, 2019		
Construction and development	\$ 515	\$ 14
1-4 Family	1,014	51
Commercial real estate	264	7
Commercial and industrial	2	—
Total	<u>\$ 1,795</u>	<u>\$ 72</u>
December 31, 2018		
Construction and development	\$ 308	\$ 13
1-4 Family	948	45
Commercial real estate	553	20
Commercial and industrial	8	—
Consumer	2	—
Total	<u>\$ 1,819</u>	<u>\$ 78</u>
December 31, 2017		
Construction and development	\$ 159	\$ 13
1-4 Family	1,255	76
Commercial real estate	592	46
Consumer	2	2
Total	<u>\$ 2,008</u>	<u>\$ 137</u>

NOTE 5. OTHER REAL ESTATE OWNED

The table below shows the activity in other real estate owned for the periods presented (dollars in thousands).

	December 31,	
	2019	2018
Balance, beginning of period	\$ 3,611	\$ 3,837
Additions	181	496
Acquired other real estate owned	1,507	—
Sales of other real estate owned	(5,148)	(155)
Write-downs	(18)	(567)
Balance, end of period	<u>\$ 133</u>	<u>\$ 3,611</u>

As of December 31, 2019 and December 31, 2018, other real estate owned related to acquisitions totaled approximately \$0.1 million and \$0.3 million, respectively. At December 31, 2019, approximately \$1.3 million of loans secured by real estate were in the process of foreclosure.

NOTE 6. BANK PREMISES AND EQUIPMENT

Bank premises and equipment consisted of the following as of the dates indicated (dollars in thousands).

	December 31,	
	2019	2018
Land	\$ 13,851	\$ 10,820
Buildings and improvements	31,926	28,147
Furniture and equipment	10,915	8,832
Software	1,373	1,329
Construction-in-progress	1,974	999
Right-of-use asset	3,309	—
Less: Accumulated depreciation and amortization	(12,432)	(9,898)
Bank premises and equipment, net	\$ 50,916	\$ 40,229

Depreciation and amortization related to bank premises and equipment charged to noninterest expense was approximately \$2.6 million, \$2.1 million and \$1.7 million for the years ended December 31, 2019, 2018 and 2017, respectively.

NOTE 7. LEASES

On January 1, 2019, the Company adopted ASU 2016-02, Leases, as further explained in Note 1, Summary of Significant Accounting Policies. The Company's primary leasing activities relate to certain real estate leases entered into in support of the Company's branch operations. Prior to the Mainland acquisition on March 1, 2019, the Company leased only one of its properties, a future branch location expected to be opened in 2020. With the Mainland acquisition, the Company increased its branch network by three branches, of which two are operated under lease agreements. In addition, the Company entered into a lease agreement in the third quarter of 2019 for its second location in the Lafayette, Louisiana market, which opened on October 28, 2019. The Company's branch locations operated under lease agreements have all been designated as operating leases. The Company does not lease equipment under operating leases, nor does it have leases designated as finance leases.

The Company determines if an arrangement is a lease at inception. Operating leases, with the exception of short-term leases, are included in operating lease right-of-use ("ROU") assets and operating lease liabilities in Bank premises and equipment, net and Accrued taxes and other liabilities, respectively, in the consolidated balance sheets. ROU assets represent the right to use an underlying asset for the lease term and lease liabilities represent the obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at the commencement date based on the present value of lease payments over the lease term. As the Company's leases do not provide an implicit rate, the Company uses its incremental borrowing rate based on the information available at the commencement date in determining the present value of lease payments. The operating lease ROU asset also includes any lease pre-payments made and excludes lease incentives. The Company's lease terms may include options to extend or terminate the lease. When it is reasonably certain that the Company will exercise an option to extend a lease, the extension is included in the lease term when calculating the present value of lease payments.

Lease expense for lease payments is recognized on a straight-line basis over the lease term. The Company has lease agreements with lease and non-lease components, which the Company has elected to account for separately, as the non-lease component amounts are readily determinable. No operating lease expense was recorded in the year ended December 31, 2018 as the Company had no operating leases until December 31, 2018.

Quantitative information regarding the Company's operating leases is presented below as of and for the year ended December 31, 2019 (dollars in thousands).

Total operating lease cost	\$	341
Weighted-average remaining lease term (in years)		10.4
Weighted-average discount rate		3.1%

As of December 31, 2019, the Company's lease ROU assets and related lease liabilities were \$3.3 million and \$3.4 million, respectively, and have remaining terms ranging from 4 to 12 years, including extension options if the Company is reasonably certain they will be exercised.

Future minimum lease payments due under non-cancelable operating leases at December 31, 2019 are presented below (dollars in thousands).

2020	\$	398
2021		403
2022		408
2023		405
2024		325
Thereafter		2,027
Total	\$	<u>3,966</u>

At December 31, 2019, the Company had not entered into any material leases that have not yet commenced.

NOTE 8. GOODWILL AND OTHER INTANGIBLE ASSETS

At December 31, 2019, goodwill and other intangible assets totaled \$31.0 million and included no accumulated impairment losses. The Company's intangible assets consist of goodwill, core deposit intangible assets arising from acquisitions, and a trademark intangible that was acquired during the year ended December 31, 2016. The Company has determined that the core deposit intangible assets have finite lives and amortizes them over the estimated useful lives of the assets.

Goodwill was recorded during the year ended December 31, 2019 as a result of the acquisitions of Mainland and Bank of York, discussed in Note 2, Business Combinations. The carrying amount of goodwill acquired from Mainland and Bank of York as of December 31, 2019 was \$4.5 million and \$4.2 million, respectively. The trademark intangible had a carrying value of \$0.1 million at December 31, 2019 and 2018.

In accordance with ASC 350, Intangibles-Goodwill and Other, the Company reviews the carrying value of indefinite-lived intangible assets at least annually, or more frequently if certain impairment indicators exist. The Company performed its annual impairment testing on October 31, 2019 and determined that there was no impairment to its goodwill or trademark intangible asset.

The table below shows a summary of the core deposit intangible assets as of the dates presented (dollars in thousands).

	December 31,	
	2019	2018
Gross carrying amount	\$ 6,467	\$ 3,097
Accumulated amortization	(1,664)	(834)
Net carrying amount	<u>\$ 4,803</u>	<u>\$ 2,263</u>

The Company acquired core deposit intangibles of \$2.4 million and \$0.9 million in the Mainland and Bank of York acquisitions, respectively, during the year ended December 31, 2019. Core deposit intangibles are being amortized over their estimated useful lives, which range from 10 to 15 years. Amortization expense for the core deposit intangible assets recorded in depreciation and amortization totaled approximately \$0.8 million, \$0.5 million, and \$0.2 million for the years ended December 31, 2019, 2018 and 2017, respectively. The future amortization schedule for the Company's core deposit intangible assets is displayed in the table below. The weighted average amortization period remaining for core deposit intangibles is 8.8 years.

(dollars in thousands)

2020	\$	960
2021		854
2022		747
2023		641
2024		534
Thereafter		1,067
	\$	<u>4,803</u>

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NOTE 9. DEPOSITS

Deposits consisted of the following as of the dates presented (dollars in thousands).

	December 31,	
	2019	2018
Noninterest-bearing demand deposits	\$ 351,905	\$ 217,457
Interest-bearing demand deposits	335,478	295,212
Money market deposit accounts	198,999	179,340
Savings accounts	115,324	104,146
Time deposits	706,000	565,576
Total deposits	<u>\$ 1,707,706</u>	<u>\$ 1,361,731</u>

The table below summarizes outstanding time deposits as of the dates indicated (dollars in thousands).

	December 31,	
	2019	2018
\$0 to \$99,999	\$ 225,951	\$ 229,105
\$100,000 to \$249,999	345,040	236,031
\$250,000 and above	135,009	100,440
	<u>\$ 706,000</u>	<u>\$ 565,576</u>

The contractual maturities of time deposits of \$100,000 or more outstanding are summarized in the table below as of the dates presented (dollars in thousands).

	December 31,	
	2019	2018
Time remaining until maturity:		
Three months or less	\$ 92,157	\$ 77,923
Over three through six months	76,179	72,397
Over six through twelve months	200,654	102,055
Over one year through three years	95,495	72,524
Over three years	15,564	11,572
	<u>\$ 480,049</u>	<u>\$ 336,471</u>

The approximate scheduled maturities of time deposits for each of the next five years are shown below (dollars in thousands).

2020	\$ 542,841
2021	102,051
2022	39,334
2023	12,843
2024	8,931
	<u>\$ 706,000</u>

Public fund deposits as of December 31, 2019 and 2018 totaled approximately \$103.4 million and \$85.0 million, respectively. The funds were secured by securities with a fair value of approximately \$89.4 million and \$74.0 million as of December 31, 2019 and 2018, respectively.

As of December 31, 2019 and 2018, total deposits outstanding to executive officers, principal shareholders, directors and to companies in which they are principal owners amounted to approximately \$76.3 million and \$49.4 million, respectively.

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NOTE 10. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

We utilize securities sold under agreements to repurchase (“repurchase agreements”) to facilitate the needs of our customers and to facilitate secured short-term funding needs. Repurchase agreements are stated at the amount of cash received in connection with the transaction. We monitor collateral levels on a continuous basis. We may be required to provide additional collateral based on the fair value of the underlying securities. Securities pledged as collateral under repurchase agreements are maintained with our safekeeping agents.

Repurchase agreements mature on a daily basis. The balances of repurchase agreements were \$3.0 million and \$2.0 million at December 31, 2019 and December 31, 2018, respectively. These funds were secured by investment securities with fair values of approximately \$2.9 million and \$3.5 million at December 31, 2019 and December 31, 2018, respectively. The interest rate paid for repurchase agreements is tiered, based on balance, and is indexed to the Federal Funds Rate. The weighted average interest rate on repurchase agreements was 0.75% and 1.67% at December 31, 2019 and December 31, 2018, respectively. The weighted-average rate paid for repurchase agreements during the year ended December 31, 2019 was 1.32% and the weighted average rate for the years ended December 31, 2018 and 2017 was 0.99% and 0.33%, respectively.

NOTE 11. SUBORDINATED DEBT SECURITIES

On November 12, 2019, the Company issued and sold \$25.0 million in aggregate principal amount of its 5.125% Fixed-to-Floating Rate Subordinated Notes (the “2029 Notes”) due December 30, 2029. Beginning on December 30, 2024, the Company may redeem the 2029 Notes, in whole or in part, at their principal amount plus any accrued and unpaid interest. The 2029 Notes bear an interest rate of 5.125% per annum until December 30, 2024, on which date the interest rate will reset quarterly to an annual interest rate equal to the then-current three-month LIBOR as calculated on each applicable date of determination, or an alternative rate determined in accordance with the terms of the 2029 Notes if the three-month LIBOR cannot be determined, plus 349.0 basis points.

On March 24, 2017, the Company issued and sold \$18.6 million in aggregate principal amount of its 6.00% Fixed-to-Floating Rate Subordinated Notes (the “2027 Notes”) due March 30, 2027. Beginning on March 30, 2022, the Company may redeem the 2027 Notes, in whole or in part, at their principal amount plus any accrued and unpaid interest. The 2027 Notes bear an interest rate of 6.00% per annum until March 30, 2022, on which date the interest rate will reset quarterly to an annual interest rate equal to the then-current LIBOR plus 394.5 basis points.

The carrying value of subordinated debt was \$42.8 million at December 31, 2019. The subordinated debt securities are recorded net of issuance costs of \$0.8 million, which are being amortized using the straight-line method over the lives of the respective securities.

NOTE 12. OTHER BORROWED FUNDS

Federal Home Loan Bank Advances

FHLB advances and weighted average interest rates at the end of the period by contractual maturity are summarized as of the dates presented (dollars in thousands).

	Amount		Weighted Average Rate	
	December 31, 2019	December 31, 2018	December 31, 2019	December 31, 2018
Fixed rate advances maturing:				
2019	\$ —	\$ 148,400	—%	2.46%
2020	53,100	3,100	1.74	1.52
2024	23,500	—	1.81	—
2028	25,000	25,000	1.77	1.77
2033	30,000	30,000	1.88	1.88
ASC 805 Fair Value Adjustment	—	(10)	—	—
	<u>\$ 131,600</u>	<u>\$ 206,490</u>	<u>1.79%</u>	<u>2.28%</u>

As of December 31, 2019, these advances are collateralized by approximately \$707.5 million of the Company’s loan portfolio and \$28.1 million of the Company’s investment securities in accordance with the Advance Security and Collateral Agreement with the FHLB. As of December 31, 2019, the Company had an additional \$594.6 million available under its line of credit with the FHLB.

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At December 31, 2019, the FHLB advances contractually maturing in 2028 and 2033 are fixed rate, nonamortizing puttable advances. Under the terms of these advances, the Bank sells the FHLB options to terminate the fixed rate advances at specified points in time prior to the stated maturity dates. The FHLB may terminate the advances on quarterly option exercise dates until maturity.

Lines of Credit

In addition, the Company has outstanding unsecured lines of credit with its correspondent banks available to assist in the management of short-term liquidity. Any balances drawn on these lines of credit mature daily. At December 31, 2019, the available balance on the unsecured lines of credit totaled approximately \$60.0 million, with no outstanding balance reflected on the consolidated balance sheet.

Junior Subordinated Debt

The following table provides a summary of the Company's junior subordinated debentures (dollars in thousands).

	<u>Face Value</u>	<u>Carrying Value</u>	<u>Maturity Date</u>	<u>Variable Interest Rate</u>	<u>Interest Rate at December 31, 2019</u>
First Community Louisiana Statutory Trust I	\$ 3,609	\$ 3,609	June 2036	3-month LIBOR + 1.77%	3.66%
BOJ Bancshares Statutory Trust I	3,093	2,288	December 2034	3-month LIBOR + 1.90%	3.79%
	<u>\$ 6,702</u>	<u>\$ 5,897</u>			

These debentures are unsecured obligations due to trusts that are unconsolidated subsidiaries. The debentures were issued in conjunction with the trusts' issuances of obligated capital securities. The trusts used the proceeds from the issuances of their capital securities to buy floating rate junior subordinated deferrable interest debentures that bear the same interest rate and terms as the capital securities. These debentures are the trusts' only assets and the interest payments from the debentures finance the distributions paid on the capital securities. These debentures rank junior and are subordinate in the right of payment to all other debt of the Company.

As part of the purchase accounting adjustments made with the BOJ acquisition on December 1, 2017, the Company adjusted the carrying value of the junior subordinated debentures to fair value as of the acquisition date. The discount on the debentures will continue to be amortized through maturity and recognized as a component of interest expense.

The debentures may be called by the Company at par plus any accrued interest. Interest on the debentures is calculated quarterly. The distribution rate payable on the capital securities is cumulative and payable quarterly in arrears. The Company has the right to defer payments of interest on the debentures at any time by extending the interest payment period for a period not exceeding 20 consecutive quarters with respect to each deferral period, provided that no extension period may extend beyond the redemption or maturity date of the debentures.

The debentures are included on the consolidated balance sheet as liabilities; however, for regulatory purposes, the carrying value of these obligations are eligible for inclusion in Tier I regulatory capital, subject to certain limitations. The total carrying values of \$5.9 million and \$5.8 million were allowed in the calculation of Tier I regulatory capital at December 31, 2019 and 2018, respectively.

NOTE 13. DERIVATIVE FINANCIAL INSTRUMENTS

As part of its liability management, the Company utilizes pay-fixed interest rate swaps to manage exposure against the variability in the expected future cash flows (future interest payments) attributable to changes in the 1-month LIBOR associated with the forecasted issuances of 1-month fixed rate debt arising from a rollover strategy. The maximum length of time over which the Company is currently hedging its exposure to the variability in future cash flows for forecasted transactions is approximately 4.6 years. As of December 31, 2019, the Company had one interest rate swap agreement with a notional amount of \$50.0 million designated as a cash flow hedge, while it had five derivative contracts with a total notional amount of \$50.0 million at December 31, 2018. The derivative contract is between the Company and a single counterparty. To mitigate credit risk, securities are pledged to the Company by the counterparty in an amount greater than or equal to the gain position of the derivative contracts.

For the year ended December 31, 2019, a gain of \$51,000, net of a \$14,000 tax expense, was recognized in “Other comprehensive (loss) income” (“OCI”) in the accompanying consolidated statements of other comprehensive income for the change in fair value of the interest rate swap contracts. For the years ended December 31, 2018 and December 31, 2017, a gain of \$0.1 million, net of a \$22,000 tax expense, and a gain of \$0.4 million, net of a \$0.1 million tax expense, respectively, was recognized in OCI in the accompanying consolidated statements of other comprehensive income for the change in fair value of the interest rate swap contracts.

The swap contracts had a fair value of \$0.7 million and \$0.6 million at December 31, 2019 and 2018, respectively, and have been recorded in “Other assets” in the accompanying consolidated balance sheets. The accumulated gain of \$0.5 million included in “Accumulated other comprehensive income (loss)” in the accompanying consolidated balance sheets would be reclassified to current earnings if the hedge transaction becomes probable of not occurring. The Company expects the hedge to remain fully effective during the remaining term of the swap contract.

Customer Derivatives – Interest Rate Swaps

In the third quarter of 2019, the Company began entering into interest rate swaps that allow commercial loan customers to effectively convert a variable-rate commercial loan agreement to a fixed-rate commercial loan agreement. Under these agreements, the Company enters into a variable-rate loan agreement with a customer in addition to an interest rate swap agreement, which serves to effectively swap the customer’s variable-rate loan into a fixed-rate loan. The Company then enters into a corresponding swap agreement with a third party in order to economically hedge its exposure through the customer agreement. The interest rate swaps with both the customers and third parties are not designated as hedges under FASB Accounting Standards Codification (“ASC”) Topic 815, Derivatives and Hedging, and are marked to market through earnings. As the interest rate swaps are structured to offset each other, changes to the underlying benchmark interest rates considered in the valuation of these instruments do not result in an impact to earnings; however, there may be fair value adjustments related to credit quality variations between counterparties, which may impact earnings as required by FASB ASC Topic 820, Fair Value Measurements. The Company did not recognize any gains or losses in other income resulting from fair value adjustments during the year ended December 31, 2019.

NOTE 14. STOCKHOLDERS’ EQUITY

Preferred Stock

The Company’s Articles of Incorporation give the Company’s board of directors the authority to issue up to 5,000,000 shares of preferred stock. At December 31, 2019, there were no preferred shares outstanding. The preferred shares are considered “blank check” preferred stock. This type of preferred stock allows the board of directors to fix the designations, preferences and relative, participating, optional or other special rights, and qualifications and limitations or restrictions of any series of preferred stock without further shareholder approval.

Common Stock

The Company’s Articles of Incorporation give the Company’s board of directors the authority to issue up to 40,000,000 shares of common stock. At December 31, 2019, there were 11,228,775 common shares outstanding compared to 9,484,219 and 9,514,926 at December 31, 2018 and 2017, respectively.

On March 1, 2019, the Company issued 763,849 shares of its common stock as consideration for the acquisition of Mainland. On December 20, 2019 the Company completed a private placement of 1,290,323 shares of its common stock at a price of \$23.25 per share. The private offering generated net proceeds of \$28.5 million.

In addition, the Company repurchased 359,906 shares of its common stock through its stock repurchase program at an average price of \$23.09 during the year ended December 31, 2019.

Dividend Restrictions. In the ordinary course of business, the Company is dependent upon dividends from the Bank to provide funds for the payment of dividends to shareholders and to provide for other cash requirements. Banking regulations may limit the amount of dividends that may be paid. Approval by regulatory authorities is required if the effect of dividends declared would cause the regulatory capital of the Bank to fall below specified minimum levels. Approval is also required if dividends declared exceed the net profits for that year combined with the retained net profits for the preceding two years. Under the foregoing dividend restrictions and while maintaining its “well capitalized” status, at December 31, 2019, the Bank could pay aggregate dividends of up to \$38.6 million to the Company without prior regulatory approval.

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Under the terms of the junior subordinated debentures, assumed through acquisition, the Company has the right at any time during the term of the debentures to defer the payment of interest. In the event that the Company elects to defer interest on the debentures, it may not, with certain exceptions, declare or pay any dividends or distributions on its common stock or purchase or acquire any of its common stock.

Under the terms of the Company's 5.125% Fixed -to-Floating Rate Subordinated Notes due 2029, the Company may not pay a dividend if either the parent company or the Bank, both immediately prior to the declaration of the dividend and after giving effect to the payment of the dividend, would not maintain regulatory capital ratios that are at "well capitalized" levels for regulatory purposes (but with respect to the parent company, only if it is required to measure and report such ratios on a consolidated basis under applicable law). The Company is also prohibited from paying dividends upon and during the continuance of any Event of Default under such notes.

These restrictions do not, and are not expected in the future to, materially limit the Company's ability to pay dividends to its shareholders in an amount consistent with the Company's history of paying dividends.

Accumulated Other Comprehensive Income (Loss)

Activity within the balances in accumulated other comprehensive income (loss), net is shown in the tables below (dollars in thousands).

	For the years ended December 31,								
	2019			2018			2017		
	Beginning of Period	Net Change	End of Period	Beginning of Period	Net Change	End of Period	Beginning of Period	Net Change	End of Period
Unrealized gain (loss), available for sale, net	\$ (1,647)	\$ 5,123	\$ 3,476	\$ (71)	\$ (1,576)	\$ (1,647)	\$ (401)	\$ 330	\$ (71)
Reclassification of realized gain, net	(1,925)	(206)	(2,131)	(1,914)	(11)	(1,925)	(1,683)	(231)	(1,914)
Unrealized loss, transfer from available for sale to held to maturity, net	5	(1)	4	7	(2)	5	8	(1)	7
Change in fair value of interest rate swap designated as a cash flow hedge, net	491	51	542	407	84	491	5	402	407
Accumulated other comprehensive income (loss)	<u>\$ (3,076)</u>	<u>\$ 4,967</u>	<u>\$ 1,891</u>	<u>\$ (1,571)</u>	<u>\$ (1,505)</u>	<u>\$ (3,076)</u>	<u>\$ (2,071)</u>	<u>\$ 500</u>	<u>\$ (1,571)</u>

NOTE 15. STOCK-BASED COMPENSATION

Equity Incentive Plan. The Company's 2017 Long-Term Incentive Compensation Plan (the "Plan") authorizes the grant of various types of equity awards, such as restricted stock, restricted stock units, stock options and stock appreciation rights to eligible participants, which include all of the Company's employees, non-employee directors, and consultants. The Plan has reserved 600,000 shares of common stock for grant, award or issuance to eligible participants, including shares underlying granted options. The Plan is administered by the Compensation Committee of the Company's Board of Directors, which determines, within the provisions of the Plan, those eligible employees to whom, and the times at which, grants and awards will be made. The Compensation Committee, in its discretion, may delegate its authority and duties under the Plan to specified officers; however, only the Compensation Committee may approve the terms of grants and awards to the Company's executive officers and directors. At December 31, 2019, approximately 396,411 shares remain available for grant.

Stock Options

During the years ended December 31, 2019, 2018 and 2017, the Company granted 36,984, 31,788 and 36,177 stock options, respectively, to key personnel that vest in one-fifth increments on the grant date anniversary of each of the following five years.

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The table below summarizes the Company's stock option activity for the periods indicated.

Stock Options

	Shares	Weighted Average Price	Weighted Average Remaining Contractual Term (Years)
Outstanding at December 31, 2016	319,364	\$ 14.36	7.67
Granted	36,177	20.25	
Forfeited	(5,334)	14.00	
Exercised	(27,290)	13.70	
Outstanding at December 31, 2017	322,917	15.09	7.19
Granted	31,788	20.25	
Forfeited	(1,644)	14.00	
Exercised	(12,415)	14.07	
Outstanding at December 31, 2018	340,646	15.98	6.49
Granted	36,984	24.40	
Forfeited	—	—	
Exercised	(20,416)	14.06	
Outstanding at December 31, 2019	357,214	16.96	5.93
Exercisable at December 31, 2019	209,610	15.19	5.27

At December 31, 2019, the shares underlying total outstanding stock options had an intrinsic value of \$2.5 million. The shares underlying exercisable stock options had an intrinsic value of approximately \$1.8 million.

The Company uses a Black-Scholes option pricing model to estimate the fair value of stock-based awards. The Black-Scholes option pricing model incorporates various subjective assumptions, including expected term and expected volatility. Stock option expense in the accompanying consolidated statements of income for the years ended December 31, 2019, 2018, and 2017 was \$0.3 million, \$0.3 million and \$0.2 million, respectively. At December 31, 2019, there was \$0.6 million of unrecognized compensation cost related to stock options that is expected to be recognized over a weighted average period of 3.0 years.

The table below shows the assumptions used for the stock options granted during the years ended December 31, 2019 and 2018.

	2019	2018
Dividend yield	0.82%	0.52%
Expected volatility	27.26%	24.99%
Risk-free interest rate	2.63%	2.68%
Expected term (in years)	6.5	6.5
Weighted-average grant date fair value	\$ 7.30	\$ 7.16

Restricted Stock and Restricted Stock Units

Under the Plan, the Company may grant restricted stock, restricted stock units, and other stock-based awards to Plan participants, subject to forfeiture upon the occurrence of certain events until the dates specified in the participant's award agreement. While restricted stock is subject to forfeiture, restricted stock participants may exercise full voting rights and will receive all dividends paid with respect to the restricted shares. Restricted stock units do not have voting rights and do not receive dividends or dividend equivalents. The restricted stock and restricted stock units granted under the Plan is typically subject to a vesting period. Compensation expense for restricted stock and restricted stock units is determined based on the market price of the Company's common stock at the grant date and is applied to the total number of shares or units granted and is recognized on a straight-line basis over the requisite service period of generally five years for employees and two years for non-employee directors. Upon vesting of restricted stock and restricted stock units, the benefit of tax deductions in excess of recognized compensation expense is reflected as an income tax benefit in the Consolidated Statements of Income.

Historically, the Company has granted restricted stock awards to Plan participants. Beginning in 2019, the Company granted time vested restricted stock units ("RSUs") to its non-employee directors and certain officers of the Company with vesting terms ranging from two years to five years.

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The Company granted a total of 79,439 restricted stock units to employees and directors for the year ended December 31, 2019. Of the restricted stock units issued in 2019, 68,430 shares will vest over five years and 11,009 shares will vest over two years.

The Company granted a total of 60,260 shares of restricted stock to employees and directors for the year ended December 31, 2018. Of the restricted stock issued in 2018, 51,263 shares will vest over five years and 8,997 shares will vest over two years.

The Company granted a total of 54,724 shares of restricted stock to employees for the year ended December 31, 2017. Of the restricted stock issued in 2017, 48,288 shares will vest over five years and 6,436 shares will vest over two years.

Compensation expense related to restricted stock and restricted stock units in the accompanying consolidated statements of income for the years ended December 31, 2019, 2018, and 2017 was \$1.1 million, \$0.8 million and \$0.6 million, respectively. The unearned compensation related to these awards is amortized to compensation expense over the vesting period. As of December 31, 2019, 2018 and 2017, unearned stock-based compensation associated with these awards totaled approximately \$2.8 million, \$2.1 million and \$1.5 million, respectively. The \$2.8 million of unrecognized compensation cost related to time vested restricted stock and restricted stock units at December 31, 2019 is expected to be recognized over a weighted average period of 3.3 years.

The following table summarizes the RSA and RSU activity for the years ended December 31, 2019 and December 31, 2018.

	December 31,			
	2019		2018	
	Shares	Weighted Avg Grant Date Fair Value	Shares	Weighted Avg Grant Date Fair Value
Balance, beginning of period	135,848	\$ 20.47	112,688	\$ 17.28
Granted	79,439	24.46	60,260	24.01
Forfeited	(5,828)	23.70	(3,441)	20.73
Earned and issued	(41,243)	19.65	(33,659)	16.75
Balance, end of period	168,216	\$ 22.43	135,848	\$ 20.47

NOTE 16. EMPLOYEE BENEFIT PLANS

The Company maintains a 401(k) defined contribution plan (the “401(k) Plan”) which covers employees over the age of twenty-one who have completed 90 days of credited service, as defined by the 401(k) Plan. The 401(k) Plan allows employees to defer a percentage of their salaries subject to certain limits based on federal tax laws. The Company makes matching contributions up to 4% of the employee’s annual salary (subject to certain maximum compensation amounts as prescribed in Internal Revenue Service guidance). Contributions by the Company and participants are immediately vested. The 401(k) Plan also allows for discretionary Company contributions in the form of cash or Company stock. Contributions in the form of Company stock are held in a portion of the 401(k) Plan that qualifies as an employee stock ownership plan (“ESOP”). The Company made a \$0.2 million contribution in the year ended December 31, 2019. The discretionary components vest in increments of 20% annually over a period of five years based on the employees’ years of service.

Employer matching contributions to the 401(k) Plan for the year ended December 31, 2019 were approximately \$0.8 million. For the years ended December 31, 2018 and 2017, employer matching contributions were approximately \$0.7 million and \$0.5 million, respectively.

In 2018, the Bank entered into Salary Continuation Agreements (“SCA”) with certain of the Company’s executive officers. The SCAs represent unfunded, non-qualified deferred compensation arrangements under the Internal Revenue Code of 1986, as amended. The SCAs between the Bank and each officer, as supplemented in 2019, provide that the officer shall receive annual payments of a fixed amount upon attaining the age of 65, with such payments payable monthly over a period of 120 months (10 years). Each officer is also entitled to certain reduced payments following a termination of employment prior to attaining age 65 (other than a termination due to death or with cause), which payments shall be made on the same schedule mentioned above.

The Company maintains a deferred compensation plan for a former employee of First Community Bank (“FCB”), a bank acquired by the Company in 2013. A single premium immediate annuity policy was purchased in which the former employee is the beneficiary. Under this policy, the beneficiary will receive monthly payments of \$2,000 through 2020. The Company also maintains a deferred compensation plan for a former employee of Citizens Bank (“Citizens”), a liability for which was assumed in the Citizens acquisition in 2017. Under the deferred compensation agreement, the former employee will receive monthly payments of \$5,500 through May of 2030.

At December 31, 2019 and 2018, the Company had a liability of \$1.6 million and \$1.1 million, respectively, in Accrued taxes and other liabilities on the consolidated balance sheets related to these deferred compensation plans.

NOTE 17. INCOME TAXES

On December 22, 2017, the Tax Cuts and Jobs Act (“TCJA”) was signed into law. The TCJA made broad and complex changes to the U.S. tax code that affected the Company’s income tax rate in 2017, including requiring the revaluation of the Company’s deferred tax assets and liabilities as of December 31, 2017 as a result of the lower corporate tax rates to be realized beginning January 1, 2018. The TCJA reduced the U.S. federal corporate income tax rate from 35% to 21% and established new tax laws that affected 2018.

The income tax expense included in the consolidated statements of income is displayed in the table below for the years ended December 31, 2019, 2018 and 2017 (dollars in thousands).

	December 31,		
	2019	2018	2017
Current	\$ 3,966	\$ 2,789	\$ 4,003
Deferred	153	841	245
Total income tax expense	<u>\$ 4,119</u>	<u>\$ 3,630</u>	<u>\$ 4,248</u>

The Company’s income tax expense for each of the years ended December 31, 2018 and 2017 includes total charges of \$0.3 million related to the revaluation of its deferred tax assets and liabilities as a result of the TCJA.

The provision for federal income taxes differs from that computed by applying the federal statutory rate of 21% in 2019 and 2018, and 35% in 2017, as indicated in the following analysis for the years ended December 31, 2019, 2018 and 2017 (dollars in thousands).

	December 31,		
	2019	2018	2017
Tax based on statutory rate	\$ 4,401	\$ 3,619	\$ 4,258
Increase (decrease) resulting from:			
Effect of tax-exempt income	(250)	(249)	(422)
Acquisition costs	32	29	174
Historical tax credits	6	6	10
Effect of tax rate change	—	338	292
Other	(70)	(113)	(64)
Total income tax expense	<u>\$ 4,119</u>	<u>\$ 3,630</u>	<u>\$ 4,248</u>
Effective rate	<u>19.7%</u>	<u>21.1%</u>	<u>34.1%</u>

The Company records deferred income tax on the tax effect of changes in timing differences.

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The net deferred tax liability or asset was comprised of the following items as of the dates indicated (dollars in thousands).

	December 31,	
	2019	2018
Deferred tax liabilities:		
Depreciation	\$ (2,903)	\$ (2,515)
FHLB stock dividend	(122)	(79)
Unrealized gain on available for sale securities	(502)	—
Basis difference in acquired assets and liabilities	(1,123)	(785)
Operating lease right-of-use asset	(695)	—
Other	(88)	(20)
Gross deferred tax liability	(5,433)	(3,399)
Deferred tax assets:		
Allowance for loan losses	2,219	1,915
Provision for other real estate losses	—	274
Unrealized loss on available for sale securities	—	818
Net operating loss carryforward	564	128
Deferred compensation	372	225
Basis difference in acquired assets and liabilities	481	442
Historical tax credit	155	160
Employee and director stock awards	419	306
Operating lease liability	709	—
Other	419	276
Gross deferred tax assets	5,338	4,544
Net deferred tax (liability) asset	\$ (95)	\$ 1,145

The Company acquired net operating loss (“NOL”) carryforwards through tax free acquisitions. As of December 31, 2019 and December 31, 2018, the Company’s NOL carryforwards were approximately \$0.5 million and \$0.6 million, respectively, and expire in 2033.

The Company files income tax returns under U.S. federal jurisdiction and the state of Louisiana, although the state of Louisiana does not assess an income tax on income resulting from banking operations. The Company is open to examination in the U.S. and the state of Louisiana for tax years ended December 31, 2016 through December 31, 2019.

NOTE 18. FAIR VALUES OF FINANCIAL INSTRUMENTS

In accordance with FASB ASC Topic 820, *Fair Value Measurement and Disclosure* (“ASC 820”), disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, is required. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions. Fair value is best determined based upon quoted market prices. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows, and the fair value estimates may not be realized in an immediate settlement of the instruments. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

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Fair Value Hierarchy

In accordance with ASC 820, the Company groups its financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 – Valuation is based upon quoted prices for identical assets or liabilities traded in active markets.

Level 2 – Valuation is based upon observable inputs other than quoted prices included in level 1, such as quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.

Level 3 – Valuation is based upon unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes certain pricing models, discounted cash flow methodologies, and similar techniques that use significant unobservable inputs.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

Cash and Due from Banks – For these short-term instruments, fair value is the carrying value. Cash and due from banks is classified in level 1 of the fair value hierarchy.

Federal Funds Sold – The fair value is the carrying value. The Company classifies these assets in level 1 of the fair value hierarchy.

Investment Securities and Equity Securities – Where quoted prices are available in an active market, the Company classifies the securities within level 1 of the valuation hierarchy. Securities are defined as both long and short positions. Level 1 securities include exchange-traded equity securities.

If quoted market prices are not available, the Company estimates fair values using pricing models and discounted cash flows that consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes, and credit spreads. Examples of such instruments, which would generally be classified within level 2 of the valuation hierarchy if observable inputs are available, include obligations of U.S. government agencies and corporations, obligations of state and political subdivisions, corporate bonds, residential mortgage-backed securities, commercial mortgage-backed securities, and other equity securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, the Company classifies those securities in level 3.

Based on market reference data, which may include reported trades; bids, offers or broker/dealer quotes; benchmark yields and spreads; as well as other reference data, management monitors the current placement of securities in the fair value hierarchy to determine whether transfers between levels may be warranted. In the fourth quarter of 2019, the Company transferred approximately \$1.3 million of corporate bonds from level 3 to level 2 based on reported trades of similar securities. At December 31, 2019, all of our level 3 investments were obligations of state and political subdivisions. The Company estimated the fair value of these level 3 investments using an option-adjusted discounted cash flow model which is based on readily traded comparable municipal credits and current spreads to the yield curves, adjusted for illiquidity of the local municipal market and sinking funds, if applicable.

Loans – The fair value of portfolio loans, net is determined using an exit price methodology. The exit price methodology continues to be based on a discounted cash flow analysis, in which projected cash flows are based on contractual cash flows adjusted for prepayments for certain loan types (e.g. residential mortgage loans and multifamily loans) and the use of a discount rate based on expected relative risk of the cash flows. The discount rate selected considers loan type, maturity date, a liquidity premium, cost to service, and cost of capital, which is a level 3 fair value estimate.

Deposit Liabilities – The fair values disclosed for noninterest-bearing demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). These noninterest-bearing deposits are classified in level 2 of the fair value hierarchy. All interest-bearing deposits are classified in level 3 of the fair value hierarchy. The carrying amounts of variable-rate (for example interest-bearing checking, savings, and money market accounts), fixed-term money market accounts, and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates on comparable instruments to a schedule of aggregated expected monthly maturities on time deposits.

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Short-Term Borrowings—The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings approximate their fair values. The Company classifies these borrowings in level 2 of the fair value hierarchy.

Long-Term Borrowings – The fair values of long-term borrowings are estimated using discounted cash flows analyses based on the Company’s current incremental borrowing rates for similar types of borrowing arrangements. The fair value of the Company’s long-term debt is therefore classified in level 3 in the fair value hierarchy.

Subordinated Debt Securities – The fair value of subordinated debt is estimated based on current market rates on similar debt in the market. The Company classifies this debt in level 2 of the fair value hierarchy.

Derivative Instruments – The fair value for interest rate swap agreements are based upon the amounts required to settle the contracts. These derivative instruments are classified in level 2 of the fair value hierarchy.

Fair Value of Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below as of the dates indicated (dollars in thousands).

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2019				
Assets:				
Obligations of U.S. government agencies and corporations	\$ 33,651	\$ —	\$ 33,651	\$ —
Obligations of state and political subdivisions	33,449	—	14,074	19,375
Corporate bonds	19,163	—	19,163	—
Residential mortgage-backed securities	101,946	—	101,946	—
Commercial mortgage-backed securities	71,596	—	71,596	—
Equity securities	2,097	2,097	—	—
Derivative financial instruments	687	—	687	—
Total assets	<u>\$ 262,589</u>	<u>\$ 2,097</u>	<u>\$ 241,117</u>	<u>\$ 19,375</u>
December 31, 2018				
Assets:				
Obligations of U.S. government agencies and corporations	\$ 7,870	\$ —	\$ 7,870	\$ —
Obligations of state and political subdivisions	33,986	—	15,178	18,808
Corporate bonds	15,509	—	14,174	1,335
Residential mortgage-backed securities	134,927	—	134,927	—
Commercial mortgage-backed securities	56,689	—	56,689	—
Equity securities	1,699	1,699	—	—
Derivative financial instruments	622	—	622	—
Total assets	<u>\$ 251,302</u>	<u>\$ 1,699</u>	<u>\$ 229,460</u>	<u>\$ 20,143</u>

Equity securities balances in the table above do not reflect balances of stock held in correspondent banks.

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The Company reviews fair value hierarchy classifications on a quarterly basis. Changes in the Company's ability to observe inputs to the valuation may cause reclassification of certain assets or liabilities within the fair value hierarchy. The table below provides a reconciliation for assets measured at fair value on a recurring basis using significant unobservable inputs, or level 3 inputs (dollars in thousands).

	Obligations of State and Political Subdivisions	Corporate Bonds	Total
Balance at December 31, 2017	\$ 19,543	\$ 1,325	\$ 20,868
Realized gains (losses) included in net income	—	—	—
Unrealized (losses) gains included in other comprehensive income	(628)	10	(618)
Purchases	—	—	—
Acquired	—	—	—
Sales	—	—	—
Maturities, prepayments, and calls	(107)	—	(107)
Transfers into Level 3	—	—	—
Transfers out of Level 3	—	—	—
Balance at December 31, 2018	\$ 18,808	\$ 1,335	\$ 20,143
Realized gains (losses) included in net income	—	—	—
Unrealized gains included in other comprehensive income	590	—	590
Purchases	—	—	—
Sales	—	—	—
Maturities, prepayments, and calls	(23)	—	(23)
Transfers into Level 3	—	—	—
Transfers out of Level 3	—	(1,335)	(1,335)
Balance at December 31, 2019	\$ 19,375	\$ —	\$ 19,375

There were no liabilities measured at fair value on a recurring basis using level 3 inputs at December 31, 2019, 2018 and 2017. For the year ended December 31, 2019 and 2018, there were no gains or losses included in earnings related to the change in fair value of the assets measured on a recurring basis using significant unobservable inputs held at the end of the period.

Fair Value of Assets Measured on a Nonrecurring Basis

Quantitative information about assets measured at fair value on a nonrecurring basis based on significant unobservable inputs (level 3) are summarized below as of the dates indicated; there were no liabilities measured on a nonrecurring basis at December 31, 2019 or 2018 (dollars in thousands).

	Estimated Fair Value	Valuation Technique	Unobservable Inputs	Range of Discounts	Weighted Average Discount
December 31, 2019					
Impaired loans	\$ 55	Discounted cash flows, Underlying collateral value	Collateral discounts and estimated costs to sell	0% - 100%	31%
December 31, 2018					
Impaired loans	\$ 383	Discounted cash flows, Underlying collateral value	Collateral discounts and estimated costs to sell	0% - 100%	15%
Other real estate owned	3,270	Underlying collateral value, Third party appraisals	Collateral discounts and discount rates	15%	15%

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The estimated fair values of the Company's financial instruments at December 31, 2019 and December 31, 2018 are shown below (dollars in thousands).

	December 31, 2019				
	Carrying Amount	Estimated Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and due from banks	\$ 44,308	\$ 44,308	\$ 44,308	\$ —	\$ —
Federal funds sold	387	387	387	—	—
Investment securities	274,214	274,285	—	245,410	28,875
Equity securities	19,315	19,316	2,097	17,219	—
Loans, net of allowance	1,681,275	1,680,364	—	—	1,680,364
Derivative financial instruments	687	687	—	687	—
Financial liabilities:					
Deposits, noninterest-bearing	\$ 351,905	\$ 351,905	\$ —	\$ 351,905	\$ —
Deposits, interest-bearing	1,355,801	1,368,194	—	—	1,368,194
FHLB short-term advances and repurchase agreements	56,095	56,095	—	56,095	—
FHLB long-term advances	78,500	76,635	—	—	76,635
Junior subordinated debt	5,897	7,747	—	—	7,747
Subordinated debt	43,600	56,399	—	56,399	—

	December 31, 2018				
	Carrying Amount	Estimated Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and due from banks	\$ 17,134	\$ 17,134	\$ 17,134	\$ —	\$ —
Federal funds sold	6	6	6	—	—
Investment securities	265,047	264,786	—	234,053	30,733
Equity securities	13,562	13,562	1,699	11,863	—
Loans, net of allowance	1,391,371	1,374,292	—	—	1,374,292
Derivative financial instruments	622	622	—	622	—
Financial liabilities:					
Deposits, noninterest-bearing	\$ 217,457	\$ 217,457	\$ —	\$ 217,457	\$ —
Deposits, interest-bearing	1,144,274	1,095,639	—	—	1,095,639
FHLB short-term advances and repurchase agreements	205,399	205,399	—	205,399	—
FHLB long-term advances	3,090	2,712	—	—	2,712
Junior subordinated debt	5,845	7,420	—	—	7,420
Subordinated debt	18,600	19,187	—	19,187	—

NOTE 19. REGULATORY MATTERS

The Company and Bank are subject to various regulatory capital requirements administered by the 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 financial statements. Under capital adequacy guidelines, the Company and Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and Bank to maintain minimum amounts and ratios (set forth in the table below) of total, Common Equity Tier 1, and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and Tier 1 capital to average assets (as defined).

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As of December 31, 2019 and 2018, the Bank was considered well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum risk-based and Tier 1 leverage capital ratios as set forth in the table below. There are no conditions or events since the regulatory framework for prompt corrective action was issued that management believes have changed the Bank's category.

The Company's and the Bank's actual capital amounts and ratios as of December 31, 2019 and December 31, 2018 are presented in the tables below (dollars in thousands).

	Actual		Capital Adequacy*		Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2019						
<u>Tier 1 leverage capital</u>						
Investar Holding Corporation	\$ 215,550	10.45%	\$ 82,546	4.00%	NA	NA
Investar Bank	222,316	10.77	82,578	4.00	103,223	5.00
<u>Common Equity Tier 1 risk-based capital</u>						
Investar Holding Corporation	209,050	11.67	125,412	7.00	NA	NA
Investar Bank	222,316	12.43	125,238	7.00	116,293	6.50
<u>Tier 1 risk-based capital</u>						
Investar Holding Corporation	215,550	12.03	152,286	8.50	NA	NA
Investar Bank	222,316	12.43	152,074	8.50	143,130	8.00
<u>Total risk-based capital</u>						
Investar Holding Corporation	269,171	15.02	188,118	10.50	NA	NA
Investar Bank	233,111	13.03	187,857	10.50	178,912	10.00
December 31, 2018						
<u>Tier 1 leverage capital</u>						
Investar Holding Corporation	\$ 172,050	9.81%	\$ 70,121	4.00%	NA	NA
Investar Bank	187,735	10.72	70,056	4.00	87,570	5.00
<u>Common Equity Tier 1 risk-based capital</u>						
Investar Holding Corporation	165,550	11.15	103,911	7.00	NA	NA
Investar Bank	187,735	12.67	103,760	7.00	96,349	6.50
<u>Tier 1 risk-based capital</u>						
Investar Holding Corporation	172,050	11.59	126,178	8.50	NA	NA
Investar Bank	187,735	12.67	125,994	8.50	118,583	8.00
<u>Total risk-based capital</u>						
Investar Holding Corporation	199,786	13.46	155,867	10.50	NA	NA
Investar Bank	197,256	13.31	155,640	10.50	148,229	10.00

*The minimum ratios and amounts under the column for Capital Adequacy for December 31, 2019 and December 31, 2018 reflect the minimum regulatory capital ratios imposed under Basel III plus the fully phased-in capital conservation buffer of 2.5%.

Applicable Federal statutes and regulations impose restrictions on the amounts of dividends that may be declared by the Company and the Bank. In addition to the formal statutes and regulations, regulatory authorities also consider the adequacy of the Company's and the Bank's total capital in relation to its assets, deposits and other such items and, as a result, capital adequacy considerations could further limit the availability of dividends from the Company and the Bank. The Company is also subject to dividend restrictions under the terms of its 2029 Notes and junior subordinated debentures. See "Common Stock - Dividend Restrictions" in Note 14, Stockholders' Equity, for more information.

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Notes to Consolidated Financial Statements

In July 2013, the federal banking regulatory agencies issued a final rule which revises the regulatory capital framework for financial institutions. The final rule (also known as the Basel III capital rules) covers a number of aspects pertaining to capital requirements.

These include:

- Increased the Prompt Corrective Action Capital Category Thresholds to be deemed well-capitalized.
- Established a Capital Conservation Buffer - The Capital Conservation Buffer was phased in through 2019.
- Changes in risk-weighting of assets.
- Opt-out Election of Accumulated Other Comprehensive Income from Common Equity Tier 1 Capital.

Financial institutions became subject to the final rule on January 1, 2015, and the rules were fully phased in as of January 1, 2019.

NOTE 20. COMMITMENTS AND CONTINGENCIES

Unfunded Commitments

The Company is a party to financial instruments with off-balance sheet risk entered into in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit consisting of loan commitments and standby letters of credit, which are not included in the accompanying financial statements. Such financial instruments are recorded in the financial statements when they become payable. The credit risk associated with these commitments is evaluated in a manner similar to the allowance for loan losses. The reserve for unfunded lending commitments is included in other liabilities in the balance sheet. At December 31, 2019 and 2018, the reserve for unfunded loan commitments was \$95,000 and \$66,000, respectively.

Commitments to extend credit are agreements to lend money with fixed expiration dates or termination clauses. The Company applies the same credit standards used in the lending process when extending these commitments, and periodically reassesses the customer's creditworthiness through ongoing credit reviews. Since some commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Collateral is obtained based on the Company's assessment of the transaction. Essentially all standby letters of credit issued have expiration dates within one year.

The table below shows the approximate amounts of the Company's commitments to extend credit as of the dates presented (dollars in thousands).

	December 31, 2019	December 31, 2018
Loan commitments	\$ 242,180	\$ 263,002
Standby letters of credit	11,475	11,114

Additionally, at December 31, 2019, the Company had unfunded commitments of \$38,000 for its investment in Small Business Investment Company qualified funds.

Insurance

The Company is obligated for certain costs associated with its insurance program for employee health. The Company is self-insured for a substantial portion of its potential claims. The Company recognizes its obligation associated with these costs, up to specified deductible limits in the period in which a claim is incurred, including with respect to both reported claims and claims incurred but not reported. The claims costs are estimated based on historical claims experience. The reserves for insurance claims are reviewed and updated by management on a quarterly basis.

Legal Proceedings

The nature of the business of the Company's banking and other subsidiaries ordinarily results in a certain amount of claims, litigation, investigations, and legal and administrative cases and proceedings, which are considered incidental to the normal conduct of business. Some of these claims are against entities which the Company acquired in business acquisitions. The Company has asserted defenses to these claims and, with respect to such legal proceedings, intends to continue to defend itself, litigating or settling cases according to management's judgment as to what is in the best interest of the Company and its shareholders.

The Company assesses its liabilities and contingencies in connection with outstanding legal proceedings utilizing the latest information available. Where it is probable that the Company will incur a loss and the amount of the loss can be reasonably estimated, the Company records a liability in its consolidated financial statements. These legal reserves may be increased or decreased to reflect any relevant developments on a quarterly basis. Where a loss is not probable or the amount of loss is not estimable, the Company does not accrue legal reserves. While the outcome of legal proceedings is inherently uncertain, based on information currently available and available insurance coverage, the Company's management believes that it has established appropriate legal reserves. Any incremental liabilities arising from pending legal proceedings are not expected to have a material adverse effect on the Company's consolidated financial position, consolidated results of operations, or consolidated cash flows. However, it is possible that the ultimate resolution of these matters, if unfavorable, may be material to the Company's consolidated financial position, consolidated results of operations, or consolidated cash flows.

As of the date of this filing, the Company believes the amount of losses associated with legal proceedings that it is reasonably possible to incur is not material.

Investment in Tax Credit Entity

In December 2014, the Company acquired a limited partnership interest in a tax-advantaged limited partnership whose purpose was to invest in an approved Federal Historic Rehabilitation tax credit project. This investment is accounted for using the cost method of accounting and is included in "Other assets" in the accompanying consolidated balance sheets. At December 31, 2019 and 2018, the recorded investment was \$0.1 million. The limited partnership is considered to be a variable interest entity ("VIE"). The VIE has not been consolidated because the Company is not considered the primary beneficiary. The Company's investment in the limited partnership was evaluated for impairment at the end of the reporting period and the Company determined there was no impairment for the year ended December 31, 2019. At December 31, 2019 and 2018, the Company had \$0.8 million invested in this partnership. The investment generated historic tax credits of \$1.0 million, all of which were recognized in the year ended December 31, 2014. The Company did not make any loans related to this real estate project. Based on the structure of this transaction, the Company expects to recover its investment solely through use of the tax credits that were generated by the investment.

NOTE 21. CONCENTRATIONS OF CREDIT

Substantially all of the Company's loans and commitments have been granted to customers in the Company's market area. The concentrations of credit by type of loan are set forth in Note 4, Loans and Allowance for Loan Losses. The distribution of commitments to extend credit approximates the distribution of loans outstanding.

The Company maintains deposit accounts and federal funds sold with correspondent banks which may, periodically, exceed the federally insured amount.

NOTE 22. TRANSACTIONS WITH RELATED PARTIES

The Bank has made, and expects in the future to continue to make in the ordinary course of business, loans to directors and executive officers of the Company, the Bank, and their affiliates. In management's opinion, these loans were made in the ordinary course of business at normal credit terms, including interest rate and collateral requirements, and do not represent more than normal credit risk. See Note 4, Loans and Allowance for Loan Losses, for more information regarding lending transactions between the Company and these related parties.

During 2019 and 2018, certain executive officers and directors of the Company and the Bank, including companies with which they are affiliated, were deposit customers of the Bank. See Note 9, Deposits, regarding total deposits outstanding to these related parties.

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The Company has transactions with related parties for which the Company believes the terms and conditions are comparable to terms that would have been available from a third party that was unaffiliated with the Company. The following describes transactions since January 1, 2016, in addition to the ordinary banking relationships described above, in which the Company has participated in which one or more of its directors, executive officers or other related persons had or will have a direct or indirect material interest.

The Company has engaged in a number of transactions with Joffrion Commercial Division, LLC (“JCD”), a commercial construction company owned and managed by Gordon H. Joffrion, one of the Company’s directors. For each transaction, the Company selected JCD through its public bidding process. The Company paid JCD approximately \$0.3 million, \$0.6 million and \$0.4 million during the years ended December 31, 2019, 2018 and 2017, respectively.

NOTE 23. PARENT ONLY BALANCE SHEETS, STATEMENTS OF OPERATIONS AND STATEMENTS OF CASH FLOWS

BALANCE SHEETS

<i>(dollars in thousands)</i>	December 31,	
	2019	2018
ASSETS		
Cash and due from bank	\$ 35,535	\$ 604
Equity securities	1,615	1,232
Accounts receivable	3	26
Due from bank subsidiary	712	451
Investment in bank subsidiary	255,141	204,347
Investment in trust	202	202
Investment in tax credit entity	87	169
Trademark intangible	100	100
Deferred tax asset	—	52
Other assets	37	81
Total assets	\$ 293,432	\$ 207,264
LIABILITIES		
Subordinated debt, net of unamortized issuance costs	\$ 42,826	\$ 18,215
Junior subordinated debt	5,897	5,845
Accounts payable	1,579	124
Accrued interest payable	465	292
Dividend payable	679	484
Due to bank subsidiary	—	42
Deferred tax liability	10	—
Total liabilities	51,456	25,002
STOCKHOLDERS' EQUITY		
Common stock	11,229	9,484
Surplus	168,658	130,133
Retained earnings	60,198	45,721
Accumulated other comprehensive income (loss)	1,891	(3,076)
Total stockholders' equity	241,976	182,262
Total liabilities and stockholders' equity	\$ 293,432	\$ 207,264

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Notes to Consolidated Financial Statements

STATEMENTS OF OPERATIONS

<i>(dollars in thousands)</i>	For the year ended December 31,	
	2019	2018
Revenue		
Dividends received from bank subsidiary	\$ 6,600	\$ 4,000
Dividends on corporate stock	30	6
Change in the fair value of equity securities	327	(265)
Interest income from investment in trust	9	8
Total revenue	6,966	3,749
Expense		
Interest on borrowings	1,686	1,486
Management fees to bank subsidiary	360	335
Acquisition expense	31	39
Other expense	440	454
Total expense	2,517	2,314
Income before income taxes and equity in undistributed income of bank subsidiary	4,449	1,435
Equity in undistributed income of bank subsidiary	11,941	11,644
Income tax benefit	449	527
Net income	\$ 16,839	\$ 13,606

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STATEMENTS OF CASH FLOWS

<i>(dollars in thousands)</i>	For the year ended December 31,	
	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 16,839	\$ 13,606
Adjustments to reconcile net loss to net cash provided by operating activities:		
Equity in undistributed earnings of bank subsidiary	(11,941)	(11,644)
Change in the fair value of equity securities	(327)	265
Amortization of debt issuance costs and purchase accounting adjustments	105	100
Net change in:		
Due from bank subsidiary	(261)	307
Other assets	25	(13)
Deferred tax asset	62	(99)
Accrued other liabilities	2,776	890
Net cash provided by operating activities	7,278	3,412
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital contributed to bank subsidiary	(23,250)	—
Repayment of investment in and advances to subsidiary	8,000	—
Distributions from investments	82	—
Purchases of equity securities	(144)	(2,189)
Proceeds from the sale of equity securities	88	1,047
Net cash used in investing activities	(15,224)	(1,142)
CASH FLOWS FROM FINANCING ACTIVITIES		
Cash dividends paid on common stock	(2,167)	(1,468)
Proceeds from common stock offering, net of issuance costs	28,525	—
Payments to repurchase common stock	(8,326)	(3,368)
Proceeds from stock options and warrants exercised	287	1,036
Proceeds from subordinated debt, net of costs	24,558	—
Net cash provided by (used in) financing activities	42,877	(3,800)
Net increase (decrease) in cash	34,931	(1,530)
Cash and cash equivalents, beginning of period	604	2,134
Cash and cash equivalents, end of period	\$ 35,535	\$ 604
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash payments for:		
Interest on borrowings	\$ 1,513	\$ 1,484

NOTE 24. EARNINGS PER SHARE

The following is a summary of the information used in the computation of basic and diluted earnings per common share for the years ended December 31, 2019, 2018 and 2017 (in thousands, except share data).

	December 31,		
	2019	2018	2017
Earnings per common share - basic			
Net income	\$ 16,839	\$ 13,606	\$ 8,202
Less: income allocated to participating securities	(164)	(192)	(110)
Net income allocated to common shareholders	\$ 16,675	\$ 13,414	\$ 8,092
Weighted-average basic shares outstanding	9,931,497	9,538,891	8,399,584
Basic earnings per common share	\$ 1.68	\$ 1.41	\$ 0.96
Earnings per common share - diluted			
Net income allocated to common shareholders	\$ 16,676	\$ 13,417	\$ 8,092
Weighted-average basic shares outstanding	9,931,497	9,538,891	8,399,584
Dilutive effect of securities	99,521	125,952	57,344
Total weighted average diluted shares outstanding	10,031,018	9,664,843	8,456,928
Diluted earnings per common share	\$ 1.66	\$ 1.39	\$ 0.96

The weighted average number of shares that have an antidilutive effect in the calculation of diluted earnings per common share and have been excluded from the computations above are shown below.

	December 31,		
	2019	2018	2017
Stock options	—	6,306	5,235
Restricted stock awards	388	1,364	1,880
Restricted stock units	7,550	—	—

NOTE 25. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

(dollars in thousands, except per share data)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Year ended December 31, 2019				
Total interest income	\$ 20,686	\$ 22,388	\$ 22,854	\$ 23,515
Total interest expense	5,530	6,057	6,488	6,550
Net interest income	15,156	16,331	16,366	16,965
Provision for loan losses	265	369	538	736
Net interest income after provision for loan losses	14,891	15,962	15,828	16,229
Gain on sale of investment securities	2	227	—	33
Other noninterest income	1,279	1,515	1,618	1,542
Noninterest expense	11,303	11,554	11,682	13,629
Income before income taxes	4,869	6,150	5,764	4,175
Income tax expense	952	1,216	1,107	844
Net income	\$ 3,917	\$ 4,934	\$ 4,657	\$ 3,331
Earnings per common share - basic	\$ 0.40	\$ 0.49	\$ 0.46	\$ 0.33
Earnings per common share - diluted	\$ 0.40	\$ 0.48	\$ 0.46	\$ 0.32

(dollars in thousands, except per share data)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Year ended December 31, 2018				
Total interest income	\$ 17,178	\$ 18,009	\$ 18,777	\$ 19,927
Total interest expense	3,320	3,689	4,392	5,120
Net interest income	13,858	14,320	14,385	14,807
Provision for loan losses	625	567	785	593
Net interest income after provision for loan losses	13,233	13,753	13,600	14,214
Gain (loss) on sale of investment securities	—	22	15	(23)
Other noninterest income	1,072	1,171	1,202	859
Noninterest expense	10,562	10,160	10,254	10,906
Income before income taxes	3,743	4,786	4,563	4,144
Income tax expense	1,341	966	516	807
Net income	\$ 2,402	\$ 3,820	\$ 4,047	\$ 3,337
Earnings per common share - basic	\$ 0.25	\$ 0.39	\$ 0.42	\$ 0.35
Earnings per common share - diluted	\$ 0.25	\$ 0.39	\$ 0.41	\$ 0.34

NOTE 26. SUBSEQUENT EVENTS

On February 21, 2020, the Bank completed its previously announced acquisition and assumption of certain assets, deposits and other liabilities associated with the Alice, Texas and Victoria, Texas locations of PlainsCapital Bank, a wholly-owned subsidiary of Hilltop Holdings Inc. In connection with the acquisition, the Bank acquired approximately \$45.9 million in loans, and approximately \$37.3 million in customer deposits.

Management has evaluated all subsequent events and transactions that occurred after December 31, 2019 up through the date that the financial statements were available to be issued and determined that there were no additional events that require disclosure. No events or changes in circumstances were identified that would have an adverse impact on the financial statements.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures

None.

Item 9A. Controls and Procedures***Evaluation of Disclosure Controls and Procedures***

As of the end of the period covered by this Annual Report on Form 10-K, the Company carried out an evaluation under the supervision and with the participation of its management, including the Chief Executive Officer and Chief Financial Officer (the Company's principal executive and financial officers), of the effectiveness of the design and operation of the Company's disclosure controls and procedures as defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective for ensuring that information the Company is required to disclose in reports that it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

Changes in Internal Control over Financial Reporting

There were no changes to internal control over financial reporting during the fourth quarter of 2019 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Management's Report on Internal Control over Financial Reporting

Management's annual report on internal control over financial reporting and the report thereon of Ernst & Young LLP are included herein under *Item 8, Financial Statements and Supplementary Data*.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Except as provided below, the information required by Item 10 is incorporated by reference to the Company's Definitive Proxy Statement for its 2020 Annual Meeting of Shareholders (the "2020 Proxy Statement").

Code of Conduct and Ethics

The Company has adopted a Code of Ethics for the Chief Executive Officer and Senior Financial Officers that applies to its chief executive officer, chief financial officer, chief accounting officer and any other senior financial officers, and the Company has also adopted a Code of Conduct that applies to all of the Company's directors, officers and employees. The full text of the Code of Ethics for the Chief Executive Officer and Senior Financial Officers and the Code of Conduct can be found by clicking on "Corporate Governance" under the "Investor Relations" tab on the Company's website, www.investarbank.com, and then by clicking on "Code of Ethics for the Chief Executive Officer and Senior Financial Officers" or "Code of Conduct," as applicable. The Company intends to satisfy the disclosure requirement under Item 5.05(c) of Form 8-K regarding an amendment to, or waiver from, a provision of the Company's Code of Ethics for the Chief Executive Officer and Senior Financial Officers by posting such information on its website, at the address specified above.

Item 11. Executive Compensation

The information required by Item 11 is incorporated by reference to the 2020 Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Stock Ownership

Except as provided below, the information required by Item 12 is incorporated by reference to the 2020 Proxy Statement.

Securities Authorized for Issuance under Equity Compensation Plans

The following table presents certain information regarding our equity compensation plans as of December 31, 2019.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans
Equity compensation plans approved by security holders ⁽¹⁾	68,772	\$ 24.35	396,411
Equity compensation plans not approved by security holders ⁽²⁾	288,442	15.20	—
Total	357,214	\$ 16.96	396,411

⁽¹⁾ Effective May 24, 2017, the Company's shareholders approved its 2017 Long-Term Incentive Compensation Plan (the "Plan") and ceased using the 2014 Long-Term Incentive Plan, discussed below. The Plan authorizes the grant of various types of equity grants and awards, such as restricted stock, stock options and stock appreciation rights to eligible participants, which include all of the Company's employees, non-employee directors, and consultants. The Plan has reserved 600,000 shares of common stock for grant, award or issuance to eligible participants, including shares underlying granted options. No awards may be granted under the Plan after May 24, 2027.

⁽²⁾ The Investar Holding Corporation 2014 Long-Term Incentive Compensation Plan (the "2014 Plan") was adopted by the Company's board of directors on January 15, 2014 and was amended on March 13, 2014. Because the Company was a private corporation at the time of the adoption of the 2014 Plan, shareholder approval of the plan was not required, nor was such approval obtained. A total of 600,000 shares of common stock was reserved for grant, award or issuance in the form of stock options and restricted stock under the 2014 Plan. Effective May 24, 2017, no future awards will be granted under the Equity Incentive Plan, although the terms and conditions of the 2014 Plan will continue to govern any outstanding awards thereunder.

Item 13. Certain Relationships and Related Transactions, and Directors Independence

The information required by Item 13 is incorporated by reference to the 2020 Proxy Statement.

Item 14. Principal Accounting Fees and Services

The information required by Item 14 is incorporated by reference to the 2020 Proxy Statement.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) Documents Filed as Part of this Report.

- (1) The following financial statements are incorporated by reference from *Item 8* hereof:

Consolidated Balance Sheets as of December 31, 2019 and 2018
 Consolidated Statements of Income for the Years Ended December 31, 2019, 2018 and 2017
 Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2019, 2018 and 2017
 Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2019, 2018 and 2017
 Consolidated Statements of Cash Flows for the Years Ended December 31, 2019, 2018 and 2017
 Notes to Consolidated Financial Statements

- (2) All schedules for which provision is made in the applicable accounting regulations of the SEC are omitted because of the absence of conditions under which they are required or because the required information is included in the consolidated financial statements and related notes thereto.

- (3) The following exhibits are filed as part of this Form 10-K, and this list includes the Exhibit Index.

Exhibit Number	Description	Location
2.1	Agreement and Plan of Reorganization dated October 10, 2018, by and among Investar Holding Corporation, Investar Bank and Mainland Bank	Exhibit 2.1 to the Current Report on Form 8-K of the Company filed October 10, 2018 and incorporated herein by reference
2.2	Agreement and Plan of Reorganization dated July 30, 2019 by and among Investar Holding Corporation, Investar Bank, and Bank of York	Exhibit 2.1 to the Current Report on Form 8-K of the Company filed July 31, 2019 and incorporated herein by reference
2.3	Agreement and Plan of Reorganization dated December 19, 2019 by and among Investar Holding Corporation, Cheaha Financial Group, Inc. and High Point Acquisition, Inc.	Exhibit 2.1 to the Current Report on Form 8-K of the Company filed December 24, 2019 and incorporated herein by reference
3.1	Restated Articles of Incorporation of Investar Holding Corporation	Exhibit 3.1 to the Registration Statement on Form S-1 of the Company filed May 16, 2014 and incorporated herein by reference
3.2	Amended and Restated By-laws of Investar Holding Corporation	Exhibit 3.2 to the Registration Statement on Form S-4 of the Company filed October 10, 2017 and incorporated herein by reference
4.1	Specimen Common Stock Certificate	Exhibit 4.1 to the Registration Statement on Form S-1 of the Company filed May 16, 2014 and incorporated herein by reference
4.2	Description of Registrant's Securities Registered under Section 12 of the Securities Exchange Act of 1934	Filed herewith
4.3	Form of 5.125% Fixed to Fluctuation Rate Subordinated Note due 2029	Exhibit 4.1 to the Current Report on Form 8-K filed November 14, 2019 and incorporated herein by reference.
4.4	Form of Registration Rights Agreement, dated December 20, 2019, by and between Investar Holding Corporation and the purchasers set forth therein.	Exhibit 4.1 to the Current Report on Form 8-K filed December 24, 2019 and incorporated herein by reference.
4.5	Indenture, dated March 24, 2017, by and between Investar Holding Corporation and Wilmington Trust, National Association, as Trustee	Exhibit 4.1 to the Current Report on Form 8-K filed March 24, 2017 and incorporated herein by reference
4.6	Supplemental Indenture, dated March 24, 2017, by and between Investar Holding Corporation and Wilmington Trust, National Association, as Trustee	Exhibit 4.2 to the Current Report on Form 8-K filed with the SEC on March 24, 2017 and incorporated herein by reference
10.1	Form of Stock Purchase Agreement, dated December 20, 2019, by and between Investar Holding Corporation and the purchasers set forth therein	Exhibit 10.1 to the Current Report on Form 8-K filed December 24, 2019 and incorporated herein by reference

10.2	Form of Subordinated Note Purchase Agreement, dated November 12, 2019, by and between Investar Holding Corporation and the purchasers set forth therein	Exhibit 10.1 to the Current Report on Form 8-K filed November 14, 2019 and incorporated herein by reference
10.3	Form of the Director Support Agreement, dated October 10, 2018, among Investar Holding Corporation, Mainland Bank and all of the directors of Mainland Bank parties thereto	Exhibit 10.3 to the Registration Statement on Form S-4 of the Company filed November 30, 2018 and incorporated herein by reference
10.4	Form of Non-Competition and Confidentiality Agreements, dated August 4, 2017, between Investar Holding Corporation and all of the directors of BOJ Bancshares, Inc.	Exhibit C to Annex A to the Registration Statement on Form S-4 of the Company filed October 10, 2017 and incorporated herein by reference
10.5	Form of Notice of Exchange and Assumption relating to options exchanged in connection with Agreement and Plan of Exchange	Exhibit 10.4 to the Registration Statement on Form S-1 of the Company filed May 16, 2014 and incorporated herein by reference
10.6	Form of Notice of Exchange and Assumption relating to restricted stock exchanged in connection with Agreement and Plan of Exchange	Exhibit 10.5 to the Registration Statement on Form S-1 of the Company filed May 16, 2014 and incorporated herein by reference
10.7	Form of Notice of Exchange and Assumption relating to warrants exchanged in connection with Agreement and Plan of Exchange	Exhibit 10.6 to the Registration Statement on Form S-1 of the Company filed May 16, 2014 and incorporated herein by reference
10.8*	Investar Holding Corporation 2017 Long-Term Incentive Compensation Plan	Exhibit 10.1 to the Current Report on Form 8-K filed May 25, 2017 and incorporated herein by reference
10.9*	Salary Continuation Agreement, dated as of February 28, 2018, by and between Investar Bank and John D'Angelo	Exhibit 10.1 to the Current Report on Form 8-K of the Company filed March 1, 2018 and incorporated herein by reference
10.10*	Supplemental Salary Continuation Agreement, dated May 22, 2019, by and between Investar Bank and John D'Angelo	Exhibit 10.1 to the Current Report on Form 8-K of the Company filed May 23, 2019 and incorporated herein by reference
10.11*	Salary Continuation Agreement, dated as of February 28, 2018, by and between Investar Bank and Chris Hufft	Exhibit 10.2 to the Current Report on Form 8-K of the Company filed March 1, 2018 and incorporated herein by reference
10.12*	Supplemental Salary Continuation Agreement, dated May 22, 2019, by and between Investar Bank and Christopher Hufft	Exhibit 10.2 to the Current Report on Form 8-K of the Company filed May 23, 2019 and incorporated herein by reference
10.13*	Salary Continuation Agreement, dated as of February 28, 2018, by and between Investar Bank and Dane Babin	Exhibit 10.3 to the Current Report on Form 8-K of the Company filed March 1, 2018 and incorporated herein by reference
10.14*	Form of Split Dollar Agreement by and between Investar Bank and each executive entering into a Salary Continuation Agreement	Exhibit 10.4 to the Current Report on Form 8-K of the Company filed March 1, 2018 and incorporated herein by reference
10.15*	Form of First Amendment to Split Dollar Agreement by and between Investar Bank and each executive entering into a Supplemental Salary Continuation Agreement	Exhibit 10.3 to the Current Report on Form 8-K filed May 23, 2019 and incorporated herein by reference
10.16*	Investar Holding Corporation 2014 Long-Term Incentive Compensation Plan, as amended by Amendment No. 1 to Investar Holding Corporation 2014 Long Term Incentive Plan	Exhibit 10.1 to the Registration Statement on Form S-1 of the Company filed May 16, 2014 and, as to Amendment No.1, Exhibit 99.2 to the Registration Statement on Form S-8 of the Company filed October 31, 2014, each of which is incorporated herein by reference
10.17*	Form of Stock Option Grant Agreement	Exhibit 10.2 to the Registration Statement on Form S-1 of the Company filed May 16, 2014 and incorporated herein by reference
10.18*	Form of Restricted Stock Award Agreement for Employees	Exhibit 10.3 to the Annual Report on Form 10-K of the Company filed March 11, 2016 and incorporated herein by reference
10.19*	Form of Restricted Stock Award Agreement for Non-Employee Directors	Exhibit 10.4 to the Annual Report on Form 10-K of the Company filed March 11, 2016 and incorporated herein by reference
10.20*	Form of Restricted Stock Unit Agreement for Employees	Exhibit 10.15 to the Annual Report on Form 10-K of the Company filed March 15, 2019 and incorporated herein by reference

10.21*	Form of Restricted Stock Unit Agreement for Non-Employee Directors	Exhibit 10.16 to the Annual Report on Form 10-K of the Company filed March 15, 2019 and incorporated herein by reference
21	Subsidiaries of the Registrant	Exhibit 21 to the Registration Statement on Form S-1 of the Company filed May 16, 2014 and incorporated herein by reference
23.1	Consent of Ernst & Young LLP	Filed herewith
31.1	Rule 13a-14(a) Certification of Principal Executive Officer of the Company in accordance with Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith
31.2	Rule 13a-14(a) Certification of Principal Financial Officer of the Company in accordance with Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith
32.1	Section 1350 Certification of Principal Executive Officer of the Company in accordance with Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith
32.2	Section 1350 Certification of Principal Financial Officer of the Company in accordance with Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith
101.INS	XBRL Instance Document	Filed herewith
101.SCH	XBRL Taxonomy Extension Schema Document	Filed herewith
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	Filed herewith
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	Filed herewith
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	Filed herewith
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	Filed herewith

* Management contract or compensatory plan or arrangement.

Item 16. Form 10-K Summary

Not applicable.

SIGNATURES

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

INVESTAR HOLDING CORPORATION

Date: March 13, 2020

by: /s/John J. D'Angelo

John J. D'Angelo
President and
Chief Executive Officer

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

Date: March 13, 2020

by: /s/John J. D'Angelo

John J. D'Angelo
President, Chief Executive
Officer and Director
(Principal Executive Officer)

Date: March 13, 2020

by: /s/Christopher L. Hufft

Christopher L. Hufft
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: March 13, 2020

by: /s/Rachel P. Cherco

Rachel P. Cherco
Executive Vice President and
Chief Accounting Officer
(Principal Accounting Officer)

Date: March 13, 2020

by: /s/James M. Baker

James M Baker
Director

Date: March 13, 2020

by: /s/Thomas C. Besselman, Sr.

Thomas C. Besselman, Sr.
Director

Date: March 13, 2020

by: /s/James H. Boyce, III

James H. Boyce, III
Director

Date: March 13, 2020 by: /s/Robert M. Boyce, Sr.
Robert M. Boyce, Sr.
Director

Date: March 13, 2020 by: /s/William H. Hidalgo, Sr.
William H. Hidalgo, Sr.
Chairman of the Board

Date: March 13, 2020 by: /s/Gordon H. Joffrion, III
Gordon H. Joffrion, III
Director

Date: March 13, 2020 by: /s/Robert C. Jordan
Robert C. Jordan
Director

Date: March 13, 2020 by: /s/David J. Lukinovich
David J. Lukinovich
Director

Date: March 13, 2020 by: /s/Suzanne O. Middleton
Suzanne O. Middleton
Director

Date: March 13, 2020 by: /s/Andrew C. Nelson, M.D.
Andrew C. Nelson, M.D.
Director

Date: March 13, 2020 by: /s/Frank L. Walker
Frank L. Walker
Director

**DESCRIPTION OF THE REGISTRANT'S SECURITIES
REGISTERED PURSUANT TO SECTION 12 OF THE
SECURITIES EXCHANGE ACT OF 1934**

As of December 31, 2019, Investar Holding Corporation, a Louisiana corporation (the "Corporation") has one class of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended: our Common Stock, par value \$1.00 per share (the "Common Stock").

The following summary description of our Common Stock is subject to and qualified in its entirety by reference to our Restated Articles of Incorporation (the "Articles") and our Amended and Restated By-laws (the "By-laws"), each of which are incorporated by reference as an exhibit to our Annual Report on Form 10-K, and the Louisiana Business Corporation Act (the "LBCA").

Authorized Capital Shares

The total number of shares of stock which the Corporation has authority to issue is 45,000,000 shares, consisting of: 5,000,000 shares of preferred stock, no par value (the "Preferred Stock"), and 40,000,000 shares of Common Stock. Each share of Common Stock is non-assessable and has the same rights, preferences and privileges as every other share of Common Stock. The Common Stock is not redeemable at the option of the Corporation. No holder of Preferred Stock or Common Stock is entitled, as such, as a matter of right, to preemptive or subscription rights to purchase any securities of the Corporation. Holders of Common Stock have no conversion rights, and there are no sinking fund provisions applicable to the Common Stock.

Preferred Stock

The Articles permit the Corporation to issue one or more series of Preferred Stock and authorize the board of directors (the "Board") to fix the designations, preferences and relative, participating, optional or other special rights (including voting rights), qualifications and limitations of any such series of Preferred Stock, without further shareholder approval except as required by the LBCA. The designations, voting powers, preferences, dividend or redemption rights or other relative rights or restrictions, limitations or qualifications of any series of Preferred Stock may differ from those of any and all other series at any time outstanding. Although the creation and authorization of Preferred Stock does not, in and of itself, have any effect on the rights of the holders of Common Stock, the issuance of one or more series of Preferred Stock may affect the holders of Common Stock in a number of respects, including the following: by subordinating the Common Stock to the Preferred Stock with respect to dividend rights, liquidation preferences and other rights, preferences, and privileges; by diluting the voting power or the earnings per share of the Common Stock; and by issuing Common Stock, upon the conversion of the Preferred Stock, at a price below the fair market value or original issue price of the Common Stock that is outstanding prior to such issuance.

Voting Rights

Each share of Common Stock entitles the holder thereof to one vote in the election of directors and on all other matters submitted to the vote of the shareholders. The holders of Common Stock are not entitled to cumulate their votes in the election of directors.

With respect to any matter other than the election of directors or a matter for which a different approval threshold is established by Louisiana law or the Articles, a matter submitted to the shareholders will be approved if a majority of the votes actually cast are in favor of such matter, at a meeting at which a quorum is present. The Articles provide that directors are elected by plurality vote.

The Articles provide that the following extraordinary actions have the shareholder approval thresholds described below:

- *Amendments to the Articles.* The Articles provide that the affirmative vote of two-thirds of the voting power which is present, in person or by proxy, at the shareholders' meeting is required to amend the Articles.
- *Merger, Consolidation or Share Exchange.* The Articles provide that, except as otherwise provided by Louisiana law, approval of a merger, consolidation or share exchange to which the Corporation is a party is subject to the affirmative vote of two-thirds of the voting power which is present, in person or by proxy, at the shareholders' meeting.
- *Dissolution or Sale of All or Substantially All of the Assets.* The Articles provide that any dissolution or sale of all or substantially all of our assets must be approved by two-thirds of the total voting power of the Corporation at a special meeting of our shareholders.

Indemnification and Limitation of Liability of Directors

The Articles and LBCA limit the personal liability of our directors and officers for monetary damages for any action taken, or any failure to take action, as a director or officer, with certain exceptions. The Articles do not eliminate or limit our right or the right of our shareholders to seek injunctive or other equitable relief not involving monetary damages. The By-laws provide for mandatory indemnification and advancement of expenses to our directors and officers, with certain exceptions. Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted pursuant to these provisions, the Corporation has been informed that in the opinion of the Securities and Exchange Commission such indemnification is against public policy and is therefore unenforceable. In addition, our ability to provide indemnification to our directors and officers is limited by federal banking laws and regulations.

Dividend Rights

Subject to the rights of holders of any Preferred Stock, holders of Common Stock are entitled to share equally in dividends when, as, and if declared by the Board out of funds legally available therefor.

Liquidation Rights

In the event of the liquidation, dissolution or winding up of the Corporation, holders of shares of Common Stock are entitled to receive, on a pro-rata per share basis, any assets available for distribution to the shareholders of the Corporation after the payment of debts and liabilities and after the distribution to holders of any outstanding shares of our capital stock hereafter issued with prior rights upon liquidation.

Selected Provisions of the LBCA and the Articles and By-laws

Certain provisions of the Articles and By-laws may have the effect of delaying, deferring or preventing a change in control of the Corporation. Such provisions, including those regulating the nomination of directors and submission of shareholder proposals, limiting who may call special shareholders' meetings and allowing the Corporation's Board to designate certain terms of and issue shares of Preferred Stock, may make it more difficult for other persons, without the approval of our Board, to make a tender offer or otherwise acquire substantial amounts of Common Stock or to launch other takeover attempts that a shareholder might consider to be in such shareholder's best interest. These provisions, which are summarized below, are designed to encourage persons seeking to acquire control of the Corporation to negotiate with the Board. The Corporation believes that, as a general rule, the interests of our shareholders are best served if any change in control results from negotiations with the Board rather than from an unsolicited proposal.

Business Combinations, Dissolution, or Sale of All or Substantially All of the Assets. As mentioned above, except as otherwise provided by Louisiana law, the Articles require a merger, consolidation or share exchange to which the Corporation is a party be approved by two-thirds of the voting power which is present, in person or by proxy, at the shareholders' meeting. The Articles require any dissolution or sale of all or substantially all of the assets of the Corporation to be approved by two-thirds of the total voting power of the Corporation at a special meeting of our shareholders.

Authorized but Unissued Capital Stock. One of the effects of the existence of authorized but unissued Common Stock and undesignated Preferred Stock may be to enable the Board to make more difficult or to discourage an attempt to obtain control of the Corporation by means of a merger, tender offer, proxy contest or otherwise, and thereby to protect the continuity of management. If, in the due exercise of its fiduciary obligations, the Board were to determine that a takeover proposal was not in the Corporation's best interest, such shares could be issued by the Board without shareholder approval in one or more transactions that might prevent or render more difficult or costly the completion of the takeover transaction by diluting the voting or other rights of the proposed acquirer or insurgent shareholder group, by putting a substantial voting block in institutional or other hands that might undertake to support the position of the incumbent Board, by effecting an acquisition that might complicate or preclude the takeover, or otherwise.

In addition, the Articles grant the Board broad power to issue, without further approval from our shareholders, a series of "blank check" Preferred Stock. This authorization may operate to provide anti-takeover protection for the Corporation because, if a merger, tender offer or other attempt to gain control of the Corporation is proposed and the Board does not believe the proposed transaction is in the Corporation or our shareholders' best interests, the Board can quickly issue shares of Preferred Stock with rights, preferences and limitations that could make the proposed takeover attempt more difficult to complete. Such Preferred Stock may also be used in connection with the issuance of a shareholder rights plan, sometimes called a "poison pill." The authorization to issue Preferred Stock may also benefit present management. Because a potential acquirer may be discouraged from attempting a takeover on account of the Board's ability to issue Preferred Stock, management may be able to retain its position more easily. The Board, however, does not intend to issue any Preferred Stock except on terms that it deems to be in our best interest and the best interest of our shareholders.

The LBCA provides that an issuance of shares or other securities convertible into or rights exercisable for shares, in a transaction or a series of integrated transactions, requires shareholder approval if both of the following conditions are satisfied: (1) the shares, other securities, or rights are issued for consideration other than cash or cash equivalents; and (2) the voting power of shares that are issued and issuable as a result of the transaction or series of integrated transactions will comprise more than 20% of the voting power of the shares of the corporation that were outstanding immediately before the transaction.

Shareholder's Right to Call a Special Meeting. Under the LBCA, we are not required to call a special shareholders' meeting at the request of any shareholder unless shareholders holding at least 10% of all the votes entitled to be cast on an issue proposed to be considered at the special meeting, sign, date and deliver to us a written demand for the meeting.

Increase in Board Size. The Board has the power to increase, between annual meetings, the number of persons serving as directors and to fill the vacancies so created. This may dissuade a third party from attempting to take control of the Corporation by means of a proxy contest.

Advance Notice Requirements. The By-laws contain requirements that shareholders provide advance notice of director nominations and other business that shareholders desire to present at a meeting of shareholders. The By-laws require a shareholder who desires to nominate a candidate for election to the Board or to raise new business at an annual shareholders' meeting to provide the Corporation advance notice not earlier than 120 days and not later than 90 days prior to the first anniversary of the immediately preceding year's annual meeting. If the date of the annual meeting is advanced by more than 30 days or delayed by more than 90 days from the anniversary date of the previous year's meeting, to be timely a shareholder must deliver advance notice not earlier than the close of business on the 120th day prior to the annual meeting and not later than the close of business on the later of the 90th day prior to such annual meeting or, if the public announcement of the date of our annual meeting is less than 120 days prior to the annual meeting, the 10th day following the day on which public announcement of the date of such meeting is first made. Any shareholder wishing to nominate a candidate for election as a director or to raise new business at an annual shareholders' meeting must also provide detailed information about the nominee or business and satisfy certain other conditions. Because of the timing requirements and the detailed information that must be provided under our advance notice by-law, a third party may be discouraged from conducting a solicitation of proxies to elect its own slate of directors or to approve its proposal without regard to whether consideration of the nominees or proposals might be harmful or beneficial to our shareholders and us.

By-law Amendment. The Board can amend the By-laws without shareholder approval.

Action by Written Consent. Under the LBCA, unless otherwise provided in a corporation's articles of incorporation, no action required or permitted to be taken at an annual or special meeting of shareholders may be taken by written consent in lieu of a meeting unless such written consent is signed by all shareholders. The Articles do not contain a provision allowing for less than unanimous written consent. As a result, the requirement that actions taken by written consent be unanimous ensures that shareholders cannot effect a business combination or other corporate action without the knowledge and involvement of all of the shareholders.

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the following Registration Statements:

- (1) Registration Statement (Form S-8 No. 333-199692) pertaining to the 2014 Long-Term Incentive Compensation Plan of Investar Holding Corporation,
- (2) Registration Statement (Form S-8 No. 333-201880) pertaining to 401(k) Plan of Investar Holding Corporation,
- (3) Registration Statement (Form S-8 No. 333-218231) pertaining to 2017 Long-Term Incentive Compensation Plan of Investar Holding Corporation;
- (4) Registration Statement (Form S-3 No. 333-215238),
- (5) Registration Statement (Form S-3MEF No. 333-216851),
- (6) Registration Statement (Form S-4 No. 333-228621), and
- (7) Registration Statement (Form S-3 No. 333-236315)

of our reports dated March 13, 2020, with respect to the consolidated financial statements of Investar Holding Corporation, and the effectiveness of internal control over financial reporting of Investar Holding Corporation included in this Annual Report (Form 10-K) for the year ended December 31, 2019.

/s/ Ernst & Young LLP

New Orleans, Louisiana
March 13, 2020

CERTIFICATIONS

SECTION 302 CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER

I, John J. D'Angelo, President and Chief Executive Officer of Investar Holding Corporation, certify that:

1. I have reviewed this annual report on Form 10-K for the year ended December 31, 2019 of Investar Holding Corporation;
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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 13, 2020

/s/ John J. D'Angelo
John J. D'Angelo
President and Chief Executive Officer
(Principal Executive Officer)

CERTIFICATIONS

SECTION 302 CERTIFICATION OF THE CHIEF FINANCIAL OFFICER

I, Christopher L. Hufft, Chief Financial Officer of Investar Holding Corporation, certify that:

1. I have reviewed this annual report on Form 10-K for the year ended December 31, 2019 of Investar Holding Corporation;
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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 13, 2020

/s/ Christopher L. Hufft

Christopher L. Hufft

Chief Financial Officer

(Principal Financial Officer)

**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)**

In connection with the Annual Report on Form 10-K of Investar Holding Corporation (the “Company”) for the fiscal year ended December 31, 2019 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, John J. D’Angelo, President and Chief Executive Officer of the Company, certify to my knowledge and in my capacity as an officer of the Company, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the periods covered in the Report.

/s/ John J. D’Angelo

John J. D’Angelo

President and Chief Executive Officer

(Principal Executive Officer)

Date: March 13, 2020

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request. The information furnished herein shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933.

**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)**

In connection with the Annual Report on Form 10-K of Investar Holding Corporation (the “Company”) for the fiscal year ended December 31, 2019 (the “Report”), I, Christopher L. Hufft, Chief Financial Officer of the Company, certify to my knowledge and in my capacity as an officer of the Company, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the periods covered in the Report.

/s/ Christopher L. Hufft
Christopher L. Hufft
Chief Financial Officer
(Principal Financial Officer)

Date: March 13, 2020

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request. The information furnished herein shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933.