

Allegiance Bancshares, Inc.  
Form 10-Q  
August 12, 2016

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**FORM 10-Q**

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

**FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2016**

**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: 001-37585**

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**Allegiance Bancshares, Inc.**

**(Exact name of registrant as specified in its charter)**

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As of August 5, 2016, there were 12,875,660 outstanding shares of the registrant's Common Stock, par value \$1.00 per share.

**ALLEGIANCE BANCSHARES, INC.**

**INDEX TO FORM 10-Q**

**JUNE 30, 2016**

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Table of Contents**PART I—FINANCIAL INFORMATION****ITEM 1. INTERIM CONSOLIDATED FINANCIAL STATEMENTS****ALLEGIANCE BANCSHARES, INC.****CONSOLIDATED BALANCE SHEETS**

	June 30, 2016	December 31, 2015
	(Unaudited)	
	(Dollars in thousands, except share data)	
<b>ASSETS</b>		
Cash and due from banks	\$ 121,913	\$ 63,380
Interest-bearing deposits at other financial institutions	88,950	85,051
Total cash and cash equivalents	210,863	148,431
Available for sale securities, at fair value	303,463	165,097
Loans held for sale	-	27,887
Loans held for investment	1,753,683	1,653,165
Less: allowance for loan losses	(14,917 )	(13,098 )
Loans, net	1,738,766	1,667,954
Accrued interest receivable	7,969	6,518
Premises and equipment, net	17,821	18,471
Other real estate owned	1,397	-
Federal Home Loan Bank stock	13,155	2,569
Branch assets held for sale	-	1,398
Bank owned life insurance	21,530	21,211
Goodwill	39,389	39,389
Core deposit intangibles, net	4,446	5,230
Other assets	8,782	8,311
<b>TOTAL ASSETS</b>	<b>\$ 2,367,581</b>	<b>\$ 2,084,579</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES:</b>		
Deposits:		
Noninterest-bearing	\$ 630,689	\$ 620,320
Interest-bearing		
Demand	111,214	97,826
Money market and savings	451,950	431,305
Certificates and other time	649,486	609,682

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Total interest-bearing deposits	1,212,650	1,138,813
Total deposits	1,843,339	1,759,133
Accrued interest payable	223	124
Short-term borrowings	30,000	50,000
Other borrowed funds	200,569	569
Subordinated debentures	9,142	9,089
Other liabilities	8,057	7,174
Total liabilities	2,091,330	1,826,089
COMMITMENTS AND CONTINGENCIES (See Note 12)		
STOCKHOLDERS' EQUITY:		
Preferred stock, \$1 par value; 1,000,000 shares authorized; there were no shares issued and outstanding of Series A or Series B, each has a \$1,000 liquidation value	-	-
Common stock, \$1 par value; 40,000,000 shares authorized; 12,869,410 shares issued and outstanding at June 30, 2016 and 12,814,696 shares issued and 12,812,985 shares outstanding at December 31, 2015	12,869	12,815
Capital surplus	210,512	209,285
Retained earnings	46,020	34,411
Accumulated other comprehensive income	6,850	2,017
Less: Treasury stock, at cost, 1,711 shares at December 31, 2015. There were no treasury shares outstanding at June 30, 2016.	-	(38 )
Total stockholders' equity	276,251	258,490
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$2,367,581	\$2,084,579

See condensed notes to interim consolidated financial statements.

Table of Contents**ALLEGIANCE BANCSHARES, INC.****CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Dollars in thousands, except per share data)			
<b>INTEREST INCOME:</b>				
Loans, including fees	\$22,839	\$21,079	\$45,067	\$41,385
Securities:				
Taxable	452	337	723	776
Tax-exempt	1,086	384	1,896	384
Deposits in other financial institutions	150	50	292	124
Total interest income	24,527	21,850	47,978	42,669
<b>INTEREST EXPENSE:</b>				
Demand, money market and savings deposits	569	525	1,113	1,037
Certificates and other time deposits	1,665	1,211	3,225	2,355
Short-term borrowings	106	2	245	2
Subordinated debentures	120	162	237	325
Other borrowed funds	118	216	125	446
Total interest expense	2,578	2,116	4,945	4,165
<b>NET INTEREST INCOME</b>	21,949	19,734	43,033	38,504
Provision for loan losses	1,645	1,420	2,355	2,103
Net interest income after provision for loan losses	20,304	18,314	40,678	36,401
<b>NONINTEREST INCOME:</b>				
Nonsufficient funds fees	145	168	308	333
Service charges on deposit accounts	173	176	318	351
Gain on sale of branch assets	-	-	2,050	-
Loss on sale of other real estate	-	-	-	(6)
Bank owned life insurance income	153	174	319	266
Other	741	429	1,521	869
Total noninterest income	1,212	947	4,516	1,813
<b>NONINTEREST EXPENSE:</b>				
Salaries and employee benefits	9,177	8,481	18,450	17,423
Net occupancy and equipment	1,214	1,274	2,446	2,358
Depreciation	415	409	832	776
Data processing and software amortization	622	827	1,275	1,453
Professional fees	401	397	935	877
Regulatory assessments and FDIC insurance	355	320	700	694
Core deposit intangibles amortization	195	207	394	415
Communications	274	358	554	692
Advertising	197	184	398	322

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Other	1,073	965	2,192	1,998
Total noninterest expense	13,923	13,422	28,176	27,008
INCOME BEFORE INCOME TAXES	7,593	5,839	17,018	11,206
Provision for income taxes	2,339	1,956	5,409	3,852
NET INCOME	5,254	3,883	11,609	7,354
Preferred stock dividends	-	260	-	386
NET INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS	\$5,254	\$3,623	\$11,609	\$6,968
EARNINGS PER COMMON SHARE:				
Basic	\$0.41	\$0.37	\$0.90	\$0.71
Diluted	\$0.40	\$0.36	\$0.89	\$0.70

See condensed notes to interim consolidated financial statements.



Table of Contents**ALLEGIANCE BANCSHARES, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(Unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Dollars in thousands)			
Net income	\$5,254	\$3,883	\$11,609	\$7,354
Other comprehensive income (loss), before tax:				
Unrealized gain (loss) on securities:				
Change in unrealized holding gain (loss) on available for sale securities during the period	6,232	(1,722)	7,435	(965 )
Reclassification of amount realized through the sale of securities	-	-	-	-
Total other comprehensive income (loss)	6,232	(1,722)	7,435	(965 )
Deferred tax expense (benefit) related to other comprehensive income (loss)	(2,181)	601	(2,602 )	329
Other comprehensive income (loss), net of tax	4,051	(1,121)	4,833	(636 )
Comprehensive income	\$9,305	\$2,762	\$16,442	\$6,718

See condensed notes to interim consolidated financial statements.

Table of Contents**ALLEGIANCE BANCSHARES, INC.****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY****(Unaudited)**

	Preferred Stock		Common Stock		Capital	Retained	Accumulated	Treasury	Total
	Shares	Amount	Shares	Amount	Surplus	Earnings	Other Comprehensive Income (Loss)	Stock	Stockholders' Equity
(In thousands, except share data)									
BALANCE AT JANUARY 1, 2015	-	\$-	7,477,309	\$7,477	\$104,568	\$19,184	\$549	\$-	\$131,777
Net income						7,354			7,354
Other comprehensive loss							(636 )		(636 )
Common stock issued in connection with the exercise of stock options and restricted stock awards			3,983	4	7			-	11
Repurchase of treasury stock								(51)	(51)
Issuance of common stock			4,884	5	103			13	121
Common stock issued in connection with the acquisition of F&M Bancshares, Inc.			2,338,520	2,339	49,108				51,447
Preferred stock issued in connection with the acquisition of F&M Bancshares, Inc.	11,550	11,550							11,550
Preferred stock dividends						(386 )			(386 )
Stock based compensation expense					642				642
BALANCE AT JUNE 30, 2015	11,550	\$11,550	9,824,696	\$9,825	\$154,428	\$26,152	\$(87 )	\$(38)	\$201,837
BALANCE AT JANUARY 1, 2016	-	\$-	12,814,696	\$12,815	\$209,285	\$34,411	\$2,017	\$(38)	\$258,470
Net income						11,609			11,609
Other comprehensive income							4,833		4,833
Common stock issued in connection with the exercise of stock options and restricted stock awards			54,714	54	520				574
Issuance of treasury stock								38	38
Stock based compensation expense					707				707
BALANCE AT JUNE 30, 2016	-	\$-	12,869,410	\$12,869	\$210,512	\$46,020	\$6,850	\$-	\$276,251

See condensed notes to interim consolidated financial statements.

Table of Contents**ALLEGIANCE BANCSHARES, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	Six Months Ended June 30,	
	2016	2015
	(Dollars in thousands)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 11,609	\$ 7,354
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and core deposit intangibles amortization	1,226	1,190
Provision for loan losses	2,355	2,103
Net amortization of premium on investments	1,329	455
Bank owned life insurance	(319 )	(266 )
Net accretion of discount on loans	(904 )	(2,350 )
Net amortization of discount on subordinated debentures	53	161
Net amortization of discount on certificates of deposit	(175 )	(460 )
Net loss on sale or write down of premises, equipment and other real estate	-	6
Net gain on sale of branch assets	(2,050 )	-
Federal Home Loan Bank stock dividends	(32 )	-
Stock based compensation expense	707	642
(Increase) decrease in accrued interest receivable and other assets	(3,549 )	214
Increase (decrease) in accrued interest payable and other liabilities	1,246	(434 )
Net cash provided by operating activities	11,496	8,615
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from maturities and principal paydowns of available for sale securities	1,962,150	474,189
Proceeds from sales of available for sale securities	-	14,748
Purchase of available for sale securities	(2,094,410)	(542,335)
Net change in total loans	(91,751 )	(152,652)
Purchase of bank premises and equipment	(196 )	(1,531 )
Purchase of bank owned life insurance	-	(10,000 )
Net purchases of Federal Home Loan Bank stock	(10,985 )	(2,898 )
Net cash paid for the sale of branch assets	(5,250 )	-
Net cash and cash equivalents acquired in the purchase of F&M Bancshares, Inc.	-	106,486
Net cash used in investing activities	(240,442 )	(113,993)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net increase (decrease) in noninterest-bearing deposits	16,897	(2,822 )
Net increase in interest-bearing deposits	93,869	4,650
Paydowns of long-term borrowings	-	(18,000 )
Proceeds from long-term borrowings	200,000	18,000
Paydowns of short-term borrowings	(20,000 )	-
Proceeds from short-term borrowings	-	75,000

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Preferred stock dividends	-	(386 )
Proceeds from the issuance of common stock, stock option exercises, restricted stock awards and the ESPP	574	132
Issuance (repurchase) of treasury stock	38	(51 )
Net cash provided by financing activities	291,378	76,523
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>62,432</b>	<b>(28,855 )</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>148,431</b>	<b>167,540</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$210,863</b>	<b>\$138,685</b>
<b>NONCASH ACTIVITIES:</b>		
Acquired loans transferred to loans held for sale	\$-	\$33,409
Acquired premises and equipment and accrued interest receivable transferred to branch assets held for sale	-	1,662
<b>SUPPLEMENTAL INFORMATION:</b>		
Income taxes paid	\$6,100	\$3,400
Interest paid	2,298	3,647

See Note 2 regarding non-cash transactions included in the F&M Bancshares, Inc. acquisition

See condensed notes to interim consolidated financial statements.

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**ALLEGIANCE BANCSHARES, INC.**

**CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2016**

**(Unaudited)**

**1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING POLICIES**

**Nature of Operations-**Allegiance Bancshares, Inc. (“Allegiance”) and its wholly-owned subsidiary, Allegiance Bank, a Texas state bank, (the “Bank”, and together with Allegiance, collectively referred to as the “Company”) provide commercial and retail loans and commercial banking services. The Company derives substantially all of its revenues and income from the operation of the Bank. The Company is focused on delivering a wide variety of relationship-driven commercial banking products and community-oriented services tailored to meet the needs of small to mid-sized businesses, professionals and individuals through its 16 offices in Houston, Texas and the surrounding region. The Bank provides its customers with a variety of banking services including checking accounts, savings accounts and certificates of deposit, and its primary lending products are commercial, personal, automobile, mortgage and home improvement loans. The Bank also offers safe deposit boxes, automated teller machines, drive-through services and 24-hour depository facilities.

**Basis of Presentation-**The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with United States Generally Accepted Accounting Principles (GAAP) for interim financial information and in accordance with guidance provided by the Securities and Exchange Commission. Accordingly, the condensed financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments considered necessary for a fair presentation of the financial position, results of operations and cash flows of the Company on a consolidated basis, and all such adjustments are of a normal recurring nature. Transactions with Allegiance have been eliminated. The condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2015. Operating results for the three and six months ended June 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. Furthermore, the acquisition of F&M Bancshares, Inc. during the first quarter of 2015 may impact the comparability of year to date 2016 versus year to date 2015 comparable information.

## **Significant Accounting and Reporting Policies**

The Company's significant accounting and reporting policies can be found in Note 1 of the Company's annual financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

### **New Accounting Standards**

#### *Adoption of New Accounting Standards*

On January 1, 2016, the Company adopted ASU 2015-16, "*Business Combinations (Topic 805) – Simplifying the Accounting for Measurement-Period Adjustments.*" ASU 2015-16 requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The acquirer must record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. Additionally, the entity is required to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. The adoption of ASU 2015-16 did not have a significant impact on the Company's financial statements.

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**ALLEGIANCE BANCSHARES, INC.**

**CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2016**

**(Unaudited)**

*Newly Issued But Not Yet Effective Accounting Standards*

ASU 2014-09 “Revenue from Contract with Customers (Topic 606).” ASU 2014-09 supersedes the revenue recognition requirements in Revenue Recognition (Topic 605), and most industry-specific guidance throughout the Industry Topics of the Codification. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 is currently effective for the Company beginning on January 1, 2018 with retrospective application to each prior reporting period presented. The Company is currently evaluating the potential impact of ASU 2014-09 on the Company’s financial statements.

ASU 2016-02 “Leases (Topic 842).” ASU 2016-02 will, among other things, require lessees to recognize a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and 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. ASU 2016-02 does not significantly change lease accounting requirements applicable to lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model and ASC Topic 606, “Revenue from Contracts with Customers.” ASU 2016-02 will be effective for the Company on January 1, 2019 and will require transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The Company is currently evaluating the potential impact of ASU 2016-02 on the Company’s financial statements.

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

*ASU No. 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing."* ASU 2016-10 was issued to clarify ASC Topic 606, "Revenue from Contracts with Customers" related to (i) identifying performance obligations; and (ii) the licensing implementation guidance. The effective date and transition of ASU 2016-10 is the same as the effective date and transition of ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)," as discussed above. The Company is currently evaluating the potential impact of ASU 2016-10 on the Company's financial statements.

## **2. ACQUISITIONS**

### ***2015 Acquisition***

*Acquisition of F&M Bancshares* - On January 1, 2015, the Company completed the acquisition of F&M Bancshares, Inc. ("F&M Bancshares") and its wholly-owned subsidiary Enterprise Bank ("Enterprise") headquartered in Houston, Texas. Enterprise operated nine banking locations, seven in Houston, Texas and two in Central Texas: one in Rosebud, Texas and one in Mart, Texas. During the first quarter of 2015, the Company consolidated two of the seven acquired Houston area locations due to the close proximity of these locations to the Company's existing banking locations. The Company acquired F&M Bancshares to further expand its Houston, Texas area market. During the first quarter of 2016, Allegiance completed the sale of the two Central Texas branch locations that were acquired as part of the F&M Bancshares acquisition. Allegiance sold \$18.2 million and \$26.6 million of loans and deposits, respectively, and recorded an after tax gain of approximately \$1.3 million on the sale of these branches.



Table of Contents**ALLEGIANCE BANCSHARES, INC.****CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS****JUNE 30, 2016****(Unaudited)**

Pursuant to the merger agreement, the Company issued 2,338,520 shares of Company common stock for all outstanding shares of F&M Bancshares capital stock and paid \$642 thousand in cash for any fractional and out of state shares held by F&M Bancshares shareholders. The Company recognized initial goodwill of \$28.2 million, which is calculated as the excess of both the consideration exchanged and liabilities assumed as compared to the fair value of identifiable assets acquired, none of which is expected to be deductible for tax purposes. F&M Bancshares results of operations were included in the Company's results beginning January 1, 2015.

The Company finalized its valuation of all assets and liabilities acquired, resulting in no changes to purchase accounting adjustments. A summary of the final purchase price allocation is as follows (dollars in thousands):

Fair value of consideration paid:	
Common shares issued (2,338,520 shares)	\$ 51,447
Preferred shares issued (11,550 shares)	11,550
Cash consideration	642
Total consideration paid	\$63,639
Fair value of assets acquired:	
Cash and cash equivalents	\$ 107,128
Investment Securities	14,722
Loans, net	404,637
Premises and equipment	7,699
Core deposit intangibles	4,313
Other assets	15,896
Total assets acquired	\$554,395
Fair value of liabilities assumed:	
Deposits	\$ 489,556
Subordinated debt	8,871
Other borrowed funds	18,000
Other liabilities	2,574
Total liabilities assumed	519,001
Fair value of net assets acquired	\$ 35,394
Goodwill resulting from acquisition	\$ 28,245

Subsequent to the acquisition, the Company paid off the \$18.0 million of borrowed funds from F&M Bancshares shareholders by drawing on its borrowing facility with another financial institution. Additionally, the securities acquired from F&M Bancshares were sold subsequent to the acquisition with no income statement impact.

On July 15, 2015, the Company redeemed all of the outstanding shares of the Company's Series A and Series B preferred stock for an aggregate redemption price of \$11.7 million (which is the sum of the liquidation amount plus accrued and unpaid dividends up to but excluding the redemption date). The Company issued the shares of Series A and Series B preferred stock in connection with the F&M Bancshares acquisition, which had preferred stock pursuant to the U.S. Treasury's Troubled Asset Relief Program.

The Company incurred approximately \$941 thousand of pre-tax merger related expenses during the year ended December 31, 2015. The merger expenses are reflected on the Company's income statement for the applicable period and are reported primarily in the categories of salaries and benefits and professional fees.

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Changes in the carrying amount of the Company's goodwill and core deposit intangible assets were as follows:

	Goodwill	Core Deposit Intangible Assets
	(Dollars in thousands)	
Balance as of January 1, 2015	\$ 11,144	\$ 1,747
Acquisition of F&M Bancshares	28,245	4,313
Amortization	-	(830 )
Balance as of December 31, 2015	39,389	5,230
Sale of branch assets	-	(390 )
Amortization	-	(394 )
Balance as of June 30, 2016	\$ 39,389	\$ 4,446

Goodwill is recorded on the acquisition date of an entity. Management performs an evaluation annually, and more frequently if a triggering event occurs, of whether any impairment of the goodwill and other intangible assets has occurred. If any such impairment is determined, a write-down is recorded. As of June 30, 2016, there were no impairments recorded on goodwill and other intangible assets. During the first quarter of 2016, the Bank completed the sale of the two Central Texas branch locations acquired from F&M Bancshares in 2015 and wrote-down the core deposit intangible assets related to those locations.

The estimated aggregate future amortization expense for core deposit intangible assets remaining as of June 30, 2016 is as follows (dollars in thousands):

Remaining 2016 \$391

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2017	781
2018	781
2019	781
2020	744
Thereafter	968
Total	\$4,446

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The amortized cost and fair value of investment securities were as follows:

	June 30, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
U.S. Government and agency securities	\$8,708	\$ 656	\$ -	\$9,364
Municipal securities	209,540	8,953	-	218,493
Agency mortgage-backed pass-through securities	26,556	651	(102 )	27,105
Corporate bonds	48,121	401	(21 )	48,501
Total	\$292,925	\$ 10,661	\$ (123 )	\$303,463

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
U.S. Government and agency securities	\$8,674	\$ 412	\$ -	\$9,086
Municipal securities	123,809	2,575	(35 )	126,349
Agency mortgage-backed pass-through securities	29,511	397	(246 )	29,662
Total	\$161,994	\$ 3,384	\$ (281 )	\$165,097

The amortized cost and fair value of investment securities at June 30, 2016, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations at any time with or without call or prepayment penalties.

	<b>Amortized Fair Cost      Value</b>	
	<b>(Dollars in thousands)</b>	
Due in one year or less	\$5,090	\$5,110
Due after one year through five years	67,854	68,636
Due after five years through ten years	74,430	77,123
Due after ten years	118,995	125,489
Subtotal	266,369	276,358
Agency mortgage-backed pass through securities	26,556	27,105
Total	\$292,925	\$303,463

As of June 30, 2016, the Company's management does not expect to sell any securities classified as available for sale with material unrealized losses; and the Company believes that the Company more likely than not will not be required to sell any of these securities before their anticipated recovery, at which time the Company will receive full value for the securities. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of June 30, 2016, management believes the unrealized losses in the previous table are temporary and no other than temporary impairment loss has been realized in the Company's consolidated statements of income.

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Securities with unrealized losses segregated by length of time such securities have been in a continuous loss position are as follows:

	June 30, 2016		More than 12 Months	Total	Estimated Unrealized	Estimated Unrealized
	Less than 12 Months	Estimated Unrealized				
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
Available for Sale	(Dollars in thousands)					
U.S. Government and agency securities	\$-	\$ -	\$ -	\$ -	\$-	\$ -
Municipal securities	229	-	185	-	414	-
Agency mortgage-backed pass-through securities	826	(4 )	6,841	(98 )	7,667	(102 )
Corporate bonds	7,752	(21 )	-	-	7,752	(21 )
Total	\$8,807	\$ (25 )	\$ 7,026	\$ (98 )	\$15,833	\$ (123 )

	December 31, 2015		More than 12 Months	Total	Estimated Unrealized	Estimated Unrealized
	Less than 12 Months	Estimated Unrealized				
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
Available for Sale	(Dollars in thousands)					
U.S. Government and agency securities	\$-	\$ -	\$ -	\$ -	\$-	\$ -
Municipal securities	6,867	(30 )	298	(5 )	7,165	(35 )
Agency mortgage-backed pass-through securities	4,952	(36 )	9,519	(210 )	14,471	(246 )
Total	\$11,819	\$ (66 )	\$ 9,817	\$ (215 )	\$21,636	\$ (281 )

During the first quarter of 2015, the Company sold all securities acquired in the F&M Bancshares acquisition, resulting in gross proceeds of approximately \$15.0 million. No gains or losses were recognized. No securities were sold during the three and six months ended June 30, 2016.

At June 30, 2016 and December 31, 2015, the Company did not own securities of any one issuer, other than the U.S government and its agencies, in an amount greater than 10% of consolidated stockholders' equity at such respective

dates.

The carrying value of pledged securities was \$4.9 million at June 30, 2016. The securities are pledged to further collateralize letters of credit issued by the Bank but confirmed by another financial institution. The Company did not have pledged securities at December 31, 2015.

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The loan portfolio balances, net of unearned income and fees, consist of various types of loans primarily made to borrowers located within Texas and are classified by major type as follows:

	June 30, 2016	December 31, 2015
	(Dollars in thousands)	
Loans held for sale (1)	\$-	\$27,887
Commercial and industrial	382,795	383,044
Mortgage warehouse	75,554	59,071
Real estate:		
Commercial real estate (including multi-family residential)	806,771	745,595
Commercial real estate construction and land development	161,572	154,646
1-4 family residential (including home equity)	214,442	205,200
Residential construction	101,677	93,848
Consumer and other	10,872	11,761
Total loans held for investment	1,753,683	1,653,165
Total loans	1,753,683	1,681,052
Allowance for loan losses	(14,917 )	(13,098 )
Loans, net	\$1,738,766	\$1,667,954

Consisted of loans at two former F&M Bancshares locations acquired in 2015 and sold during the first quarter of 2016. At December 31, 2015, loans held for sale consisted of \$13.2 million of commercial and industrial loans, (1) \$11.6 million of commercial real estate (including multi-family residential) loans, \$2.3 million of 1-4 family residential (including home equity) loans and \$803 thousand of consumer and other loans. Loans held for sale were carried at the lower of aggregate cost or fair value.

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An aging analysis of the recorded investment in past due loans, segregated by class of loans, is as follows:

	June 30, 2016					
	Loans Past Due and Still Accruing					
	30-89 Days	90 or More Days Due	Past Due Loans	Nonaccrual Loans	Current Loans	Total Loans
	(Dollars in thousands)					
Commercial and industrial	\$956	\$-	\$956	\$2,723	\$379,116	\$382,795
Mortgage warehouse	-	-	-	-	75,554	75,554
Real estate:						
Commercial real estate (including multi-family residential)	628	-	628	4,141	802,002	806,771
Commercial real estate construction and land development	890	-	890	-	160,682	161,572
1-4 family residential (including home equity)	213	-	213	227	214,002	214,442
Residential construction	-	-	-	-	101,677	101,677
Consumer and other	-	-	-	33	10,839	10,872
Total loans	\$2,687	\$-	\$2,687	\$7,124	\$1,743,872	\$1,753,683
	December 31, 2015					
	Loans Past Due and Still Accruing					
	30-89 Days	90 or More Days Due	Past Due Loans	Nonaccrual Loans	Current Loans	Total Loans
	(Dollars in thousands)					
Loans held for sale	\$539	\$-	\$539	\$209	\$27,139	\$27,887
Commercial and industrial	1,474	-	1,474	2,664	378,906	383,044
Mortgage warehouse	-	-	-	-	59,071	59,071
Real estate:						
Commercial real estate (including multi-family residential)	1,866	-	1,866	2,006	741,723	745,595
Commercial real estate construction and land development	77	-	77	-	154,569	154,646
1-4 family residential (including home equity)	1,904	-	1,904	239	203,057	205,200
Residential construction	-	-	-	-	93,848	93,848

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Consumer and other	36	-	36	66	11,659	11,761
Total loans held for investment	5,357	-	5,357	4,975	1,642,833	1,653,165
Total loans	\$5,896	\$-	\$5,896	\$5,184	\$1,669,972	\$1,681,052

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Impaired loans by class of loans are set forth in the following tables. The average recorded investment presented in the table below is reported on a year-to-date basis.

	<b>June 30, 2016</b>				
	<b>Recorded Investment</b>	<b>Unpaid Principal Balance</b>	<b>Related Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>
	<b>(Dollars in thousands)</b>				
With no related allowance recorded:					
Commercial and industrial	\$3,037	\$ 3,782	\$ -	\$ 3,548	\$ 98
Mortgage warehouse	-	-	-	-	-
Real estate:					
Commercial real estate (including multi-family residential)	11,154	11,240	-	11,599	222
Commercial real estate construction and land development	-	-	-	-	-
1-4 family residential (including home equity)	227	227	-	233	8
Residential construction	-	-	-	-	-
Consumer and other	11	11	-	13	-
Total	14,429	15,260	-	15,393	328
With an allowance recorded:					
Commercial and industrial	2,365	2,365	936	2,411	66
Mortgage warehouse	-	-	-	-	-
Real estate:					
Commercial real estate (including multi-family residential)	-	-	-	-	-
Commercial real estate construction and land development	-	-	-	-	-
1-4 family residential (including home equity)	-	-	-	-	-
Residential construction	-	-	-	-	-
Consumer and other	22	22	13	25	1
Total	2,387	2,387	949	2,436	67

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Total:					
Commercial and industrial	5,402	6,147	936	5,959	164
Mortgage warehouse	-	-	-	-	-
Real estate:					
Commercial real estate (including multi-family residential)	11,154	11,240	-	11,599	222
Commercial real estate construction and land development	-	-	-	-	-
1-4 family residential (including home equity)	227	227	-	233	8
Residential construction	-	-	-	-	-
Consumer and other	33	33	13	38	1
	\$16,816	\$17,647	\$ 949	\$ 17,829	\$ 395

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	Year Ended December 31, 2015				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)				
With no related allowance recorded:					
Commercial and industrial	\$3,842	\$4,216	\$ -	\$ 3,698	\$ 222
Mortgage warehouse	-	-	-	-	-
Real estate:					
Commercial real estate (including multi-family residential)	4,700	4,700	-	4,833	285
Commercial real estate construction and land development	-	-	-	-	-
1-4 family residential (including home equity)	239	239	-	248	13
Residential construction	-	-	-	-	-
Consumer and other	82	97	-	102	8
Total	8,863	9,252	-	8,881	528
With an allowance recorded:					
Commercial and industrial	1,573	1,573	670	2,040	87
Mortgage warehouse	-	-	-	-	-
Real estate:					
Commercial real estate (including multi-family residential)	1,146	1,146	180	1,122	77
Commercial real estate construction and land development	-	-	-	-	-
1-4 family residential (including home equity)	-	-	-	-	-
Residential construction	-	-	-	-	-
Consumer and other	19	19	9	21	1
Total	2,738	2,738	859	3,183	165
Total:					
Commercial and industrial	5,415	5,789	670	5,738	309
Mortgage warehouse	-	-	-	-	-
Real estate:					
Commercial real estate (including multi-family residential)	5,846	5,846	180	5,955	362
Commercial real estate construction and land development	-	-	-	-	-
1-4 family residential (including home equity)	239	239	-	248	13
Residential construction	-	-	-	-	-
Consumer and other	101	116	9	123	9
Total	\$11,601	\$11,990	\$ 859	\$ 12,064	\$ 693

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The total average recorded investment of impaired loans for the six months ended June 30, 2015 was \$7.1 million. Total interest income recognized for the six months ended June 30, 2015 on impaired loans was \$186 thousand.

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**ALLEGIANCE BANCSHARES, INC.**

**CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2016**

**(Unaudited)**

**Credit Quality Indicators**

The company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt, including factors such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends. The Company analyzes loans individually by classifying the loans by credit risk. As part of the ongoing monitoring of the credit quality of the Company's loan portfolio and methodology for calculating the allowance for credit losses, management assigns and tracks risk ratings to be used as credit quality indicators.

The following is a general description of the risk ratings used:

**Watch**—Loans classified as watch loans may still be of high quality, but have an element of risk added to the credit such as declining payment history, deteriorating financial position of the borrower or a decrease in collateral value.

**Special Mention**—Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

**Substandard**—Loans classified as substandard have well-defined weaknesses on a continuing basis and are inadequately protected by the current net worth and paying capacity of the borrower, impaired or declining collateral values, or a continuing downturn in their industry which is reducing their profits to below zero and having a significantly negative impact on their cash flow. These classified loans are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

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



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Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans.

Based on the most recent analysis performed, the risk category of loans by class of loan at June 30, 2016 is as follows:

	Pass	Watch	Special Mention	Substandard	Doubtful	Total
	(Dollars in thousands)					
Commercial and industrial	\$358,753	\$2,683	\$7,001	\$ 14,358	\$ -	\$382,795
Mortgage warehouse	75,554	-	-	-	-	75,554
Real estate:						
Commercial real estate (including multi-family residential)	766,685	7,620	5,378	27,088	-	806,771
Commercial real estate construction and land development	152,267	7,410	-	1,895	-	161,572
1-4 family residential (including home equity)	210,009	300	2,054	2,079	-	214,442
Residential construction	101,677	-	-	-	-	101,677
Consumer and other	10,480	262	3	127	-	10,872
Total loans	\$1,675,425	\$18,275	\$14,436	\$ 45,547	\$ -	\$1,753,683

Table of Contents**ALLEGIANCE BANCSHARES, INC.****CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS****JUNE 30, 2016****(Unaudited)**

The following table presents the risk category of loans by class of loan at December 31, 2015:

	Pass	Watch	Special Mention	Substandard	Doubtful	Total
	(Dollars in thousands)					
Loans held for sale	\$26,570	\$477	\$ 19	\$ 821	\$ -	\$27,887
Commercial and industrial	366,479	8,094	1,253	7,218	-	383,044
Mortgage warehouse	59,071	-	-	-	-	59,071
Real estate:						
Commercial real estate (including multi-family residential)	721,781	7,186	790	15,838	-	745,595
Commercial real estate construction and land development	152,380	1,846	-	420	-	154,646
1-4 family residential (including home equity)	200,262	2,385	390	2,163	-	205,200
Residential construction	93,848	-	-	-	-	93,848
Consumer and other	11,522	155	18	66	-	11,761
Total loans held for investment	1,605,343	19,666	2,451	25,705	-	1,653,165
Total loans	\$1,631,913	\$20,143	\$2,470	\$26,526	\$-	\$1,681,052

**Allowance for Loan Losses**

The following table presents the activity in the allowance for loan losses by portfolio type for the three and six months ended June 30, 2016 and June 30, 2015:

Commercial and industrial	Commercial real estate (including multi-family residential)	Commercial real estate construction and land development	1-4 family residential (including home equity)	Residential construction	Consumer and other	Total
(Dollars in thousands)						

Allowance for loan losses:

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Three Months Ended

Balance March 31, 2016	\$4,057	\$ -	\$ 5,905	\$ 1,352	\$ 1,484	\$ 889	\$ 70	\$13,757
Provision for loan losses	480	-	984	16	158	(2 )	9	1,645
Charge-offs	(442 )	-	(43 )	-	-	-	(12 )	(497 )
Recoveries	10	-	-	-	-	-	2	12
Net charge-offs	(432 )	-	(43 )	-	-	-	(10 )	(485 )
Balance June 30, 2016	\$4,105	\$ -	\$ 6,846	\$ 1,368	\$ 1,642	\$ 887	\$ 69	\$14,917

Six Months Ended

Balance January 1, 2016	\$3,644	\$ -	\$ 5,914	\$ 1,221	\$ 1,432	\$ 820	\$ 67	\$13,098
Provision for loan losses	859	-	1,061	147	200	67	21	2,355
Charge-offs	(443 )	-	(129 )	-	-	-	(22 )	(594 )
Recoveries	45	-	-	-	10	-	3	58
Net charge-offs	(398 )	-	(129 )	-	10	-	(19 )	(536 )
Balance June 30, 2016	\$4,105	\$ -	\$ 6,846	\$ 1,368	\$ 1,642	\$ 887	\$ 69	\$14,917

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**ALLEGIANCE BANCSHARES, INC.**

**CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2016**

**(Unaudited)**

	<b>Commercial and industrial</b>	<b>Mortgage warehouse</b>	<b>Commercial real estate (including multi-family residential)</b>	<b>Commercial real estate construction and land development</b>	<b>1-4 family residential (including home equity)</b>	<b>Residential construction</b>	<b>Consumer and other</b>	<b>Total</b>
(Dollars in thousands)								
Allowance for loan losses:								
Three Months Ended								
Balance March 31, 2015	\$2,960	\$ -	\$ 3,551	\$ 646	\$ 1,130	\$ 596	\$ 57	\$8,940
Provision for loan losses	(6 )	-	982	196	125	111	12	1,420
Charge-offs	(70 )	-	-	-	-	-	(2 )	(72 )
Recoveries	21	-	-	-	-	3	-	24
Net charge-offs	(49 )	-	-	-	-	3	(2 )	(48 )
Balance June 30, 2015	\$2,905	\$ -	\$ 4,533	\$ 842	\$ 1,255	\$ 710	\$ 67	\$10,312
Six Months Ended								
Balance January 1, 2015	\$2,334	\$ -	\$ 3,799	\$ 578	\$ 1,008	\$ 475	\$ 52	\$8,246
Provision for loan losses	614	-	734	264	247	213	31	2,103
Charge-offs	(82 )	-	-	-	-	-	(18 )	(100 )
Recoveries	39	-	-	-	-	22	2	63
Net charge-offs	(43 )	-	-	-	-	22	(16 )	(37 )
Balance June 30, 2015	\$2,905	\$ -	\$ 4,533	\$ 842	\$ 1,255	\$ 710	\$ 67	\$10,312

The following table presents the balance in the allowance for loan losses by portfolio type based on the impairment method as of June 30, 2016 and December 31, 2015:

<b>Commercial and industrial</b>	<b>Mortgage warehouse</b>	<b>Commercial real estate (including multi-family residential)</b>	<b>Commercial real estate construction and land development</b>	<b>1-4 family residential (including home equity)</b>	<b>Residential construction</b>	<b>Consumer and other</b>	<b>Total</b>
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**residential) development**

(Dollars in thousands)

Allowance for loan losses

related to:

June 30, 2016

Individually evaluated for impairment	\$936	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 13	\$949
Collectively evaluated for impairment	3,169	-	6,846	1,368	1,642	887	56	13,968
Total allowance for loan losses	\$4,105	\$ -	\$ 6,846	\$ 1,368	\$ 1,642	\$ 887	\$ 69	\$14,917

December 31, 2015

Individually evaluated for impairment	\$670	\$ -	\$ 180	\$ -	\$ -	\$ -	\$ 9	\$859
Collectively evaluated for impairment	2,974	-	5,734	1,221	1,432	820	58	12,239
Total allowance for loan losses	\$3,644	\$ -	\$ 5,914	\$ 1,221	\$ 1,432	\$ 820	\$ 67	\$13,098

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**ALLEGIANCE BANCSHARES, INC.**

**CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2016**

**(Unaudited)**

The following table presents the recorded investment in loans held for investment by portfolio type based on the impairment method as of June 30, 2016 and December 31, 2015:

	Commercial and industrial	Commercial Mortgage and warehouse	Commercial real estate (including multi-family residential)	Commercial real estate construction and land development	Commercial family residential (including home equity)	Residential construction	Consumer and other	Total
(Dollars in thousands)								
Recorded investment in loans:								
June 30, 2016								
Individually evaluated for impairment	\$5,402	\$-	\$11,154	\$-	\$227	\$-	\$33	\$16,816
Collectively evaluated for impairment	377,393	75,554	795,617	161,572	214,215	101,677	10,839	1,736,807
Total loans evaluated for impairment	\$382,795	\$75,554	\$806,771	\$161,572	\$214,442	\$101,677	\$10,872	\$1,753,611
December 31, 2015								
Individually evaluated for impairment	\$5,415	\$-	\$5,846	\$-	\$239	\$-	\$101	\$11,601
Collectively evaluated for impairment	377,629	59,071	739,749	154,646	204,961	93,848	11,660	1,641,573
Total loans evaluated for impairment	\$383,044	\$59,071	\$745,595	\$154,646	\$205,200	\$93,848	\$11,761	\$1,653,109

**Troubled Debt Restructurings**

Following is a summary of loans modified under troubled debt restructurings during the six months ended June 30, 2016 and June 30, 2015:

	As of June 30, 2016		2015	
Number of Contracts	Pre- Modification Contracts	Post- Modification of	Number of Contracts	Post- Modification of

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	Outstanding Recorded Investment		Outstanding Recorded Investment		Outstanding Recorded Investment	
	(Dollars in thousands)					
Troubled Debt Restructurings						
Commercial and industrial	12	\$ 2,931	\$ 2,931	3	\$ 2,049	\$ 2,043
Mortgage warehouse						
Real estate:						
Commercial real estate (including multi-family residential)	6	6,250	6,250	-	-	-
Commercial real estate construction and land development	-	-	-	-	-	-
1-4 family residential (including home equity)	-	-	-	-	-	-
Residential construction	-	-	-	-	-	-
Consumer and other	1	7	7	-	-	-
Total	19	\$ 9,188	\$ 9,188	3	\$ 2,049	\$ 2,043

As of June 30, 2016 and December 31, 2015, the Company had a recorded investment in troubled debt restructurings of \$11.7 million and \$3.1 million, respectively. The Company allocated \$642 thousand and \$681 thousand of specific reserves for troubled debt restructurings at June 30, 2016 and December 31, 2015, respectively, and did not commit to lend additional amounts on these loans. As of June 30, 2016 and June 30, 2015, there were no loans modified under troubled debt restructurings during the previous twelve month period that subsequently defaulted during the six months ended June 30, 2016 and June 30, 2015, respectively. The modifications primarily related to extending the amortization periods of the loans. Default is determined at 90 or more days past due.

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**ALLEGIANCE BANCSHARES, INC.**

**CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2016**

**(Unaudited)**

**6. FAIR VALUE**

The Company uses fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Fair value represents the exchange price that would be received from selling an asset or paid to transfer a liability, otherwise known as an “exit price”, in the principal or most advantageous market available to the entity in an orderly transaction between market participants on the measurement date.

**Fair Value Hierarchy**

The Company groups 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. These levels are:

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

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

Level 3—Significant unobservable inputs that reflect management’s judgment and assumptions that market participants would use in pricing an asset or liability that are supported by little or no market activity.

The carrying amounts and estimated fair values of financial instruments that are reported on the balance sheet are as follows:

As of June 30, 2016



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	Carrying	Estimated Fair Value			Total
	Amount	Level 1	Level 2	Level 3	
Financial assets	(Dollars in thousands)				
Cash and cash equivalents	\$210,863	\$210,863	\$-	\$-	\$210,863
Available for sale securities	303,463	-	303,463	-	303,463
Loans held for investment, net of allowance	1,738,766	-	-	1,743,626	1,743,626
Accrued interest receivable	7,969	7	2,766	5,196	7,969
Financial liabilities					
Total deposits	\$1,843,339	\$-	\$1,846,235	-	\$1,846,235
Accrued interest payable	223	-	223	-	223
Short-term borrowings	30,000	-	30,000	-	30,000
Other borrowed funds	200,569	-	200,569	-	200,569
Subordinated debentures	9,142	-	9,142	-	9,142

	As of December 31, 2015				
	Carrying	Estimated Fair Value			Total
	Amount	Level 1	Level 2	Level 3	
Financial assets	(Dollars in thousands)				
Cash and cash equivalents	\$148,431	\$148,431	\$-	\$-	\$148,431
Available for sale securities	165,097	-	165,097	-	165,097
Loans held for sale	27,887	-	-	27,887	27,887
Loans held for investment, net of allowance	1,640,067	-	-	1,641,862	1,641,862
Accrued interest receivable	6,518	-	1,780	4,738	6,518
Financial liabilities					
Total deposits	\$1,759,133	\$-	\$1,759,728	\$-	\$1,759,728
Accrued interest payable	124	-	124	-	124
Short-term borrowings	50,000	-	50,000	-	50,000
Other borrowed funds	569	-	569	-	569
Subordinated debentures	9,089	-	9,089	-	9,089

The fair value estimates presented above are based on pertinent information available to management as of the dates indicated. The methods used to determine fair value are described in our audited financial statements which are presented in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

Table of Contents**ALLEGIANCE BANCSHARES, INC.****CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS****JUNE 30, 2016****(Unaudited)**

The following tables present fair values for assets measured at fair value on a recurring basis:

	As of June 30, 2016		
	Level 1	Level 2	Level 3 Total
	(Dollars in thousands)		
Available for sale securities:			
U.S. Government and agency securities	\$-	\$9,364	\$ - \$9,364
Municipal securities	-	218,493	- 218,493
Agency mortgage-backed pass-through securities	-	27,105	- 27,105
Corporate bonds	-	48,501	- 48,501
	\$-	\$303,463	\$ - \$303,463

	As of December 31, 2015		
	Level 1	Level 2	Level 3 Total
	(Dollars in thousands)		
Available for sale securities:			
U.S. Government and agency securities	\$-	\$9,086	\$ - \$9,086
Municipal securities	-	126,349	- 126,349
Agency mortgage-backed pass-through securities	-	29,662	- 29,662
	\$-	\$165,097	\$ - \$165,097

There were no liabilities measured at fair value on a recurring basis as of June 30, 2016 or December 31, 2015. There were no transfers between levels during the six months ended June 30, 2016 or June 30, 2015.

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances such as evidence of impairment.

As of June 30, 2016  
Level 1 Level 2 Level 3

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(Dollars in thousands)

Impaired loans:			
Commercial and industrial	\$-	\$ -	\$1,429
Commercial real estate (including multi-family residential)	-	-	-
Consumer and other	-	-	9
Other real estate owned	-	-	-
	\$-	\$ -	\$1,438

As of December 31, 2015

Level 1 Level 2 Level 3  
(Dollars in thousands)

Impaired loans:			
Commercial and industrial	\$-	\$ -	\$903
Commercial real estate (including multi-family residential)	-	-	966
Consumer and other	-	-	10
	\$-	\$ -	\$1,879

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**ALLEGIANCE BANCSHARES, INC.**

**CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2016**

**(Unaudited)**

Historically, we measure fair value for certain loans and other real estate owned on a nonrecurring basis.

**Impaired Loans**

During the six months ended June 30, 2016 and the year ended December 31, 2015, certain impaired loans were reevaluated and reported at fair value through a specific allocation of the allowance for loan losses. At June 30, 2016, the total reported fair value of impaired loans of \$1.4 million based on collateral valuations utilizing Level 3 valuation inputs had a carrying value of \$2.4 million that was reduced by specific allowance allocations totaling \$949 thousand. At December 31, 2015, the total reported fair value of impaired loans of \$1.9 million based on collateral valuations utilizing Level 3 valuation inputs had a carrying value of \$2.7 million that was reduced by specific allowance allocations totaling \$859 thousand.

**Other Real Estate Owned**

At June 30, 2016, the balance of other real estate owned included \$1.4 million of foreclosed commercial real estate properties recorded as a result of obtaining physical possession of the property. The Company did not have any other real estate owned at December 31, 2015.

**7. DEPOSITS**

Time deposits that meet or exceed the Federal Deposit Insurance Corporation Insurance limit of \$250 thousand at June 30, 2016 and December 31, 2015 were \$177.0 million and \$164.7 million, respectively.

Scheduled maturities of time deposits for the next five years are as follows (dollars in thousands):

Within one year	\$424,731
After one but within two years	101,392
After two but within three years	89,490
After three but within four years	13,018
After four but within five years	20,855
Total	\$649,486

## 8. BORROWINGS

The Company has an available line of credit with the Federal Home Loan Bank (“FHLB”) of Dallas, which allows the Company to borrow on a collateralized basis. FHLB advances are short-term borrowings and are used to manage liquidity as needed. Maturing advances are replaced by drawing on available cash, making additional borrowings or through increased customer deposits. At June 30, 2016, the Company had a total borrowing capacity of \$624.2 million, of which \$363.7 million was available and \$260.5 million was outstanding. Short-term FHLB advances of \$30.0 million were outstanding at June 30, 2016, at a weighted average rate of 0.56%. Long-term FHLB borrowings of \$200.0 million were outstanding at June 30, 2016, at a weighted average rate of 0.36%. Letters of credit were \$30.5 million at June 30, 2016, of which \$2.5 million will expire in August 2016, \$25.0 million will expire in October 2016 and \$3.0 million will expire in February 2017.

Table of Contents**ALLEGIANCE BANCSHARES, INC.****CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS****JUNE 30, 2016****(Unaudited)**

In 2015, the Company borrowed an additional \$18.0 million under a revolving credit agreement with another financial institution. The borrowing under this revolving credit agreement matures in December 2021. The Company used the funds borrowed in 2015 under this revolving credit agreement to repay amounts owed by F&M Bancshares under a previous borrowing agreement with another financial institution entered into during 2013 in conjunction with the purchase of Independence Bank. In October 2015, the Company paid down \$27.5 million under this revolving credit agreement with a portion of the proceeds from the Company's initial public offering. The revolving credit agreement requires the Company to meet certain restrictive covenants. At June 30, 2016, the Company believes it is in compliance with all such covenants and had not been made aware of any noncompliance by the lender. The interest rate on the debt is the Prime rate minus 25 basis points, or 3.25%, at June 30, 2016, and is paid quarterly. Scheduled principal maturities are as follows (dollars in thousands):

Remaining 2016	\$-
2017	-
2018	-
2019	-
2020 and thereafter	569
Total	\$569

**9. SUBORDINATED DEBENTURES**

On January 1, 2015, the Company acquired F&M Bancshares and assumed Farmers & Merchants Capital Trust II and Farmers & Merchants Capital Trust III. Each of these trusts is a capital or statutory business trust organized for the sole purpose of issuing trust securities and investing the proceeds in the Company's junior subordinated debentures. The preferred trust securities of each trust represent preferred beneficial interests in the assets of the respective trusts and are subject to mandatory redemption upon payment of the junior subordinated debentures held by the trust. The common securities of each trust are wholly owned by the Company. Each trust's ability to pay amounts due on the trust preferred securities is solely dependent upon the Company making payment on the related junior subordinated debentures. The debentures, which are the only assets of each trust, are subordinate and junior in right of payment to all of the Company's present and future senior indebtedness. The Company has fully and unconditionally guaranteed each trust's obligations under the trust securities issued by such trust to the extent not paid or made by such trust, provided such trust has funds available for such obligations.

Under the provisions of each issue of the debentures, the Company has the right to defer payment of interest on the debentures at any time, or from time to time, for periods not exceeding five years. If interest payments on either issue of the debentures are deferred, the distributions on the applicable trust preferred securities and common securities will also be deferred.

The Company assumed the junior subordinated debentures with an aggregate original principal amount of \$11.3 million and a current fair value at June 30, 2016 of \$9.1 million. At acquisition, the Company recorded a discount of \$2.5 million on the debentures. The difference between the carrying value and contractual balance will be recognized as a yield adjustment over the remaining term for the debentures. At June 30, 2016, the Company had \$11.3 million outstanding in junior subordinated debentures issued to the Company's unconsolidated subsidiary trusts. The junior subordinated debentures are included in Tier 1 capital under current regulatory guidelines and interpretations.

Table of Contents**ALLEGIANCE BANCSHARES, INC.****CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS****JUNE 30, 2016****(Unaudited)**

A summary of pertinent information related to the Company's issues of junior subordinated debentures outstanding at June 30, 2016 is set forth in the table below:

Description	Issuance Date	Trust Preferred Securities Outstanding	Interest Rate (1)	Junior Subordinated Debt Owed to Trusts	Maturity Date (2)
(Dollars in thousands)					
Farmers & Merchants Capital Trust II	November 13, 2003	\$7,500	3 month LIBOR + 3.00%	\$7,732	November 8, 2035
Farmers & Merchants Capital Trust III	June 30, 2005	3,500	3 month LIBOR + 1.80%	3,609	July 7, 2035
				\$11,341	

(1) The 3-month LIBOR in effect as of June 30, 2016 was 0.6516%.

(2) All debentures are currently callable.

**10. INCOME TAXES**

The amount of the Company's federal and state income tax expense is influenced by the amount of the Company's pre-tax income, the amount of tax-exempt income and the amount of other nondeductible items. For the three and six months ended June 30, 2016, income tax expense was \$2.3 million and \$5.4 million, respectively, compared with \$2.0 million and \$3.9 million, respectively, for the three and six months ended June 30, 2015, respectively. The increase in income tax expense year over year was primarily attributable to higher pre-tax earnings. The effective income tax rate for the three and six months ended June 30, 2016 was 30.8% and 31.8%, respectively, compared to 33.5% and 34.4%, respectively, for the three and six months ended June 30, 2015. The effective tax rate decreased for the three and six months ended June 30, 2016 compared to the same periods in 2015 primarily due to the increase in tax free income from the purchase of additional municipal securities.

Interest and penalties related to tax positions are recognized in the period in which they begin accruing or when the entity claims the position that does not meet the minimum statutory thresholds. The Company has not recorded any



interest and penalties in its income statement for the three and six months ended June 30, 2016 and June 30, 2015. The Company is no longer subject to examination by the U.S. Federal Tax Jurisdiction for the years prior to 2012.

## **11. STOCK BASED COMPENSATION**

During 2008, the Company's Board of Directors and shareholders approved the 2008 Stock Awards and Incentive Plan (the "Plan") that permits certain key employees to purchase shares of the Company's stock. The Plan was amended in 2015 as the shareholders authorized a maximum aggregate number of shares of stock to be issued of 1,460,000, any or all of which may be issued through incentive stock options. The Company accounts for stock based employee compensation plans using the fair value-based method of accounting. The Company recognized total stock based compensation expense of \$354 thousand and \$707 thousand for the three and six months ended June 30, 2016, respectively, and \$330 thousand and \$642 thousand for the three and six months ended June 30, 2015, respectively.

### **Stock Option Plan**

Options to purchase a total of 1,185,381 shares of Company stock have been granted as of June 30, 2016. Under the stock option plan, options are exercisable up to 10 years from the date of the grant, unless otherwise provided by the Board of Directors, and are fully vested 4 years after the date of grant.

The fair value of stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model.

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**ALLEGIANCE BANCSHARES, INC.**

**CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2016**

**(Unaudited)**

A summary of the activity in the stock option plan during the six months ended June 30, 2016 is set forth below:

	Number of Options  (In thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term  (In years)	Aggregate Intrinsic Value  (In thousands)
Options outstanding, January 1, 2016	969	\$ 17.45	6.62	\$ 6,006
Options granted	51	19.64		
Options exercised	(25 )	12.68		
Options forfeited	(19 )	21.78		
Options outstanding, June 30, 2016	976	\$ 17.59	6.35	\$ 7,113
Options vested and exercisable, June 30, 2016	580	\$ 15.18	4.90	\$ 5,625

**Share Award Plan**

During 2016, the Company issued 14,401 shares of restricted stock. The restricted stock shares will vest over a period of 4 years but are considered outstanding at the date of issuance. The Company accounts for restricted stock grants by recording the fair value of the grant as compensation expense over the vesting period.

A summary of the activity of the nonvested shares of restricted stock during the six months ended June 30, 2016 is as follows:

Number of Shares  (Shares in thousands)	Weighted Average Grant Date Fair Value
--	---

Nonvested share awards outstanding, January 1, 2016	18	\$ 19.68
Share awards granted	14	19.71
Share awards vested	(7 )	19.06
Unvested share awards forfeited	-	-
Nonvested share awards outstanding, June 30, 2016	25	\$ 18.31

## 12. OFF-BALANCE SHEET ARRANGEMENTS, COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Company enters into various transactions, which, in accordance with accounting principles generally accepted in the United States, are not included in the Company's consolidated balance sheets. The Company enters into these transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and standby and commercial letters of credit, which involve to varying degrees elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The Company uses the same credit policies in making commitments and conditional obligations as it does for on balance sheet instruments.

Table of Contents**ALLEGIANCE BANCSHARES, INC.****CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS****JUNE 30, 2016****(Unaudited)**

The contractual amounts of financial instruments with off-balance sheet risk at June 30, 2016 are as follows:

	June 30, 2016		December 31, 2015	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
	(Dollars in thousands)			
Commitments to extend credit	\$392,810	\$160,272	\$252,662	\$222,198
Standby letters of credit	8,172	-	9,456	-
Total	\$400,982	\$160,272	\$262,118	\$222,198

Commitments to make loans are generally made for an approval period of 120 days or fewer. As of June 30, 2016, the funded fixed rate loan commitments have interest rates ranging from 1.60% to 7.50% with a weighted average maturity and rate of 1.78 years and 4.55%, respectively.

**Litigation**

From time to time, the Company is subject to claims and litigation arising in the ordinary course of business. In the opinion of management, the Company is not party to any legal proceedings the resolution of which it believes would have a material adverse effect on the Company's business, prospects, financial condition, liquidity, results of operation, cash flows or capital levels. However, one or more unfavorable outcomes in any claim or litigation against the Company could have a material adverse effect for the period in which such claim or litigation is resolved. In addition, regardless of their merits or their ultimate outcomes, such matters are costly, divert management's attention and may materially adversely affect the Company's reputation, even if resolved in its favor. The Company intends to defend itself vigorously against any future claims or litigation.

**13. REGULATORY CAPITAL MATTERS**

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Capital adequacy guidelines include prompt corrective action regulations and involve quantitative measures of assets, liabilities and certain off balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weightings, and other factors. Any institution that fails to meet its minimum capital requirements is subject to actions by regulators that could have a direct material effect on the Company's financial statements. The Company is subject to the Basel III regulatory capital framework (the "Basel III Rules"). The Basel III Rules became effective for the Company on January 1, 2015, with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Starting in January 2016, the implementation of the capital conservation buffer was effective for the Company starting at the 0.625% level and increasing 0.625% each year thereafter, until it reaches 2.5% on January 1, 2019. The capital conservation buffer is designed to absorb losses during periods of economic stress and requires increased capital levels for the purpose of capital distributions and other payments. Failure to meet the full amount of the buffer will result in restrictions on the Company's ability to make capital distributions, including dividend payments and stock repurchases and to pay discretionary bonuses to executive officers. Management believes as of June 30, 2016 and December 31, 2015 the Company and the Bank met all capital adequacy requirements to which they were then subject.

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

The following is a summary of the Company's and the Bank's actual and required capital ratios at June 30, 2016 and December 31, 2015:

	Actual		For Capital Adequacy Purposes		To Be Categorized As Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>ALLEGIANCE BANCSHARES, INC.</b>						
<b>(Consolidated)</b>						
As of June 30, 2016						
Total Capital (to Risk Weighted Assets)	\$251,405	12.92 %	\$155,639	8.00 %	N/A	N/A
Common Equity Tier 1 Capital (to Risk Weighted Assets)	227,346	11.69 %	87,547	4.50 %	N/A	N/A
Tier I Capital (to Risk Weighted Assets)	236,488	12.16 %	116,729	6.00 %	N/A	N/A
Tier I Capital (to Average Tangible Assets)	236,488	10.43 %	90,690	4.00 %	N/A	N/A
As of December 31, 2015						
Total Capital (to Risk Weighted Assets)	\$237,178	12.92 %	\$146,811	8.00 %	N/A	N/A
Common Equity Tier 1 Capital (to Risk Weighted Assets)	214,991	11.72 %	82,581	4.50 %	N/A	N/A
Tier I Capital (to Risk Weighted Assets)	224,080	12.21 %	110,109	6.00 %	N/A	N/A
Tier I Capital (to Average Tangible Assets)	224,080	11.02 %	81,315	4.00 %	N/A	N/A
<b>ALLEGIANCE BANK</b>						
As of June 30, 2016						
Total Capital (to Risk Weighted Assets)	\$232,737	11.97 %	\$155,590	8.00 %	\$194,488	10.00 %
Common Equity Tier 1 Capital (to Risk Weighted Assets)	217,820	11.20 %	87,519	4.50 %	126,417	6.50 %
Tier I Capital (to Risk Weighted Assets)	217,820	11.20 %	116,693	6.00 %	155,590	8.00 %
Tier I Capital (to Average Tangible Assets)	217,820	9.61 %	90,668	4.00 %	113,335	5.00 %

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As of December 31, 2015

Total Capital (to Risk Weighted Assets)	\$219,487	11.96%	\$146,779	8.00%	\$183,474	10.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	206,389	11.25%	82,563	4.50%	119,258	6.50%
Tier I Capital (to Risk Weighted Assets)	206,389	11.25%	110,084	6.00%	146,779	8.00%
Tier I Capital (to Average Tangible Assets)	206,389	10.16%	81,291	4.00%	101,614	5.00%

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Table of Contents**ALLEGIANCE BANCSHARES, INC.****CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS****JUNE 30, 2016****(Unaudited)****14. EARNINGS PER COMMON SHARE**

Diluted earnings per common share is computed using the weighted-average number of common shares determined for the basic earnings per common share computation plus the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock using the treasury stock method. Outstanding stock options issued by the Company represent the only dilutive effect reflected in diluted weighted average shares. Restricted shares are considered outstanding at the date of grant and are included in basic and diluted weighted average common shares outstanding.

	Three Months Ended June 30,		Six Months Ended June 30,					
	2016	2015	2016	2015	Amount	Per Share Amount	Amount	Per Share Amount
	(Dollars in thousands)							
	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount
Net income attributable to common stockholders	\$5,254		\$3,623		\$11,609		\$6,968	
Basic:								
Weighted average common shares outstanding	12,857	\$0.41	9,825	\$0.37	12,849	\$0.90	9,824	\$0.71
Diluted:								
Add incremental shares for:								
Dilutive effect of stock option exercises	182		179		154		177	
Total	13,039	\$0.40	10,004	\$0.36	13,003	\$0.89	10,001	\$0.70

Stock options for 267 thousand shares were not considered in computing diluted earnings per common share as of June 30, 2015 because they were antidilutive. There were no antidilutive shares as of June 30, 2016.





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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*Except where the context otherwise requires or where otherwise indicated, in this Quarterly Report on Form 10-Q the terms "we," "us," "our," "Company" and "our business" refer to Allegiance Bancshares, Inc. and our wholly-owned banking subsidiary, Allegiance Bank, a Texas banking association, and the terms "Allegiance Bank" or the "Bank" refer to Allegiance Bank. In this Quarterly Report on Form 10-Q, we refer to the Houston-The Woodlands-Sugar Land metropolitan statistical area as the "Houston metropolitan area."*

***Cautionary Notice Regarding Forward-Looking Statements***

Statements and financial discussion and analysis contained in this Quarterly Report on Form 10-Q that are not historical facts are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. We also may make forward-looking statements in our other documents filed or furnished with the SEC. In addition, our senior management may make forward-looking statements orally to investors, analysts, representatives of the media and others. Statements preceded by, followed by or that otherwise include the words "believes," "expects," "anticipates," "intends," "projects," "estimates," "plans" and similar expressions or future or conditional verbs such as "will," "should," "would," "may" and "could" are generally forward-looking in nature and not historical facts, although not all forward looking statements include the foregoing. Forward-looking statements are based on assumptions and involve a number of risks and uncertainties, many of which are beyond our control. Many possible events or factors could affect our future financial results and performance and could cause such results or performance to differ materially from those expressed in our forward-looking statements.

While there is no assurance that any list of risks and uncertainties or risk factors is complete, below are certain factors which could cause our actual results to differ from those in our forward-looking statements:

- risks related to the concentration of our business in the Houston metropolitan area, including risks associated with volatility or decreases in oil and gas prices or prolonged periods of lower oil and gas prices;
- general market conditions and economic trends nationally, regionally and particularly in the Houston metropolitan area;
- our ability to retain executive officers and key employees and their customer and community relationships;
- our ability to recruit and retain successful bankers that meet our expectations in terms of customer and community relationships and profitability;
- risks related to our strategic focus on lending to small to medium-sized businesses;
- our ability to implement our growth strategy, including through the identification of acquisition candidates that will be accretive to our financial condition and results of operations;
- risks related to any businesses we acquire in the future, including exposure to potential asset and credit quality risks and unknown or contingent liabilities, the time and costs associated with integrating systems, technology platforms, procedures and personnel, the need for additional capital to finance such transactions and possible failures in realizing

the anticipated benefits from such acquisitions;

- potential impairment on the goodwill we have recorded or may record in connection with business acquisitions;
- risks associated with our owner-occupied commercial real estate loan and other commercial real estate loan portfolios, including the risks inherent in the valuation of the collateral securing such loans;
- risks associated with our commercial and industrial loan portfolio, including the risk for deterioration in value of the general business assets that generally secure such loans;
- the accuracy and sufficiency of the assumptions and estimates we make in establishing reserves for potential loan losses and other estimates;
- risk of deteriorating asset quality and higher loan charge-offs;
- time and effort necessary to resolve nonperforming assets;
- potential changes in the prices, values and sales volumes of commercial and residential real estate securing our real estate loans;
- changes in market interest rates that affect the pricing of our loans and deposits and our net interest income;
- potential fluctuations in the market value and liquidity of the securities we hold for sale;
- risk of impairment of investment securities, goodwill, other intangible assets or deferred tax assets;

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the effects of competition from a wide variety of local, regional, national and other providers of financial, investment and insurance services, which may adversely affect our pricing and terms;

our ability to maintain an effective system of disclosure controls and procedures and internal controls over financial reporting;

risks associated with fraudulent and negligent acts by our customers, employees or vendors;

our ability to keep pace with technological change or difficulties when implementing new technologies;

risks associated with system failures or failures to protect against cybersecurity threats, such as breaches of our network security;

risks associated with data processing system failures and errors;

the institution and outcome of litigation and other legal proceeding against us or to which we become subject;

our ability to maintain adequate liquidity and to raise necessary capital to fund our acquisition strategy and operations or to meet increased minimum regulatory capital levels;

our ability to comply with various governmental and regulatory requirements applicable to financial institutions;

the impact of recent and future legislative and regulatory changes, including changes in banking, securities and tax laws and regulations and their application by our regulators, such as the further implementation of the Dodd-Frank Act;

governmental monetary and fiscal policies, including the policies of the Federal Reserve;

our ability to comply with supervisory actions by federal and state banking agencies;

changes in the scope and cost of FDIC insurance and other coverage;

systemic risks associated with the soundness of other financial institutions; and

other risks and uncertainties listed from time to time in our reports and documents filed with the SEC.

Further, these forward-looking statements speak only as of the date on which they were made and we undertake no obligation to update or revise any forward-looking statements to reflect events or circumstances after the date on which these statements are made or to reflect the occurrence of unanticipated events, unless required to do so under the federal securities laws. Other factors not identified above, including those described under the headings “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” may also cause actual results to differ materially from those described in our forward looking statements. Most of these factors are difficult to anticipate and are generally beyond our control. You should consider these factors in connection with considering any forward-looking statements that may be made by us.

## *Overview*

We generate most of our revenues from interest income on loans, service charges on customer accounts and interest income from investments in securities. We incur interest expense on deposits and other borrowed funds and noninterest expenses such as salaries and employee benefits and occupancy expenses. Net interest income is the difference between interest income on earning assets such as loans and securities and interest expense on liabilities such as deposits and borrowings that are used to fund those assets. Net interest income is our largest source of revenue. To evaluate net interest income, we measure and monitor (1) yields on our loans and other interest-earning assets, (2) the interest expenses of our deposits and other funding sources, (3) our net interest spread and (4) our net interest margin. Net interest spread is the difference between rates earned on interest-earning assets and rates paid on interest-bearing liabilities. Net interest margin is calculated as net interest income divided by average interest-earning assets. Because noninterest-bearing sources of funds, such as noninterest-bearing deposits and stockholders’ equity, also fund interest-earning assets, net interest margin includes the benefit of these noninterest-bearing sources.

Our net interest income is affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, referred to as a “volume change.” Periodic changes in the volume and types of loans in our loan portfolio are affected by, among other factors, economic and competitive conditions in Texas and specifically in the Houston metropolitan area, as well as developments affecting the real estate, technology, financial services, insurance, transportation, manufacturing and energy sectors within our target market and throughout the state of Texas.

Our net interest income is also affected by changes in yields earned on interest-earning assets and rates paid on interest-bearing deposits and other borrowed funds, referred to as a “rate change.” Fluctuations in market interest rates are driven by many factors, including governmental monetary policies, inflation, deflation, macroeconomic developments, changes in unemployment, the money supply, political and international conditions and conditions in domestic and foreign financial markets.

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Our objective is to grow and strengthen our community banking franchise by deploying our super-community banking strategy and pursuing select strategic acquisitions in the Houston metropolitan area. We are positioning the Bank to be a leading provider of personalized commercial banking services by emphasizing the strength and capabilities of local bank office management and providing superior customer service. We have made the strategic decision to focus on the Houston metropolitan area because of our deep roots and experience operating through a variety of economic cycles in this large and vibrant market.

***Super-community banking strategy.*** Our super-community banking strategy emphasizes community involvement by its directors, officers and employees, which allows us to be responsive in developing our products and services. Our approach produces a clear competitive advantage by delivering an extraordinary customer experience and fostering a culture dedicated to achieving both superior external and internal service levels. Greater efficiency results from our focus on serving a select, but significant, portion of the overall banking market, and on the operational leverage that results from a market share driven by geographic concentration. We focus on establishing personal relationships with customers through superior service, which is accomplished in part by empowering our personnel to make certain business decisions at a local level in order to respond quickly to customers' needs. We emphasize lending to and banking with small to medium-sized businesses, for which we believe loans can be priced on terms that are more attractive to us than would be achieved by lending to larger businesses. We operate full-service decentralized branches and employ lenders with strong underwriting credentials who are authorized to make loan and underwriting decisions up to prescribed limits at the branch level. We support branch operations with a centralized credit approval process for larger credit relationships, loan operations, information technology, core data processing, accounting, finance, treasury and treasury management support, deposit operations and executive and board oversight.

We plan to continue to emphasize the super-community banking strategy to organically grow our presence in the Houston metropolitan area through:

- increasing the productivity of existing bankers, as measured by loans, deposits and fee income per banker, while enhancing profitability by leveraging our existing operating platform;
- focusing on local and individualized decision-making, allowing us to provide customers with rapid decisions on loan requests, which we believe allows us to effectively compete with larger financial institutions;
- identifying and hiring additional seasoned bankers in our existing and target markets in the Houston metropolitan area who will thrive utilizing our super-community banking model, and opening additional branches where we are able to attract seasoned bankers; and
- developing new products designed to serve the increasingly diversified Houston economy, while preserving our strong culture of risk management.

***Select strategic acquisitions.*** We intend to continue to expand our market position in the Houston metropolitan area through organic growth, including with the establishment of de novo branch locations, and through a disciplined acquisition strategy. We focus on like-minded community banks with similar lending strategies to our own when evaluating acquisition opportunities. We believe that our management's experience in assessing, executing and

integrating target institutions will allow us to capitalize on acquisition opportunities. On January 1, 2015, we completed the acquisition of F&M Bancshares Inc. (“F&M Bancshares”) and its subsidiary bank, Enterprise Bank (“Enterprise”). The results for the three and six months ended June 30, 2016 and June 30, 2015 reflect the combined entity.

### ***Recent Developments***

On January 31, 2016, the Bank completed the sale of its two Central Texas branch locations that were acquired as part of the F&M Bancshares acquisition, to Incommons Bank, N.A., a national banking association headquartered in Mexia, Texas. Under the terms of the purchase and assumption agreement, Incommons Bank, N.A. acquired certain assets and assumed certain liabilities associated with the Mart branch location at 714 Texas Avenue in Mart, Texas and the Rosebud branch location at 339 Main Street in Rosebud, Texas. Allegiance sold \$18.2 million and \$26.6 million of loans and deposits, respectively, and recorded an after tax gain of approximately \$1.3 million on the sale of these branches.

### ***Critical Accounting Policies***

Our accounting policies are integral to understanding our results of operations. Our accounting policies are described in detail in Note 1 to our Annual Report on Form 10-K for the year ended December 31, 2015. We believe that of our accounting policies, the following may involve a higher degree of judgment and complexity:

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### *Securities*

Securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value. Unrealized gains and losses are excluded from earnings and reported, net of tax, as a separate component of stockholders' equity until realized. Securities within the available for sale portfolio may be used as part of our asset/liability strategy and may be sold in response to changes in interest rate risk, prepayment risk or other similar economic factors.

Interest earned on these assets is included in interest income. Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: (1) OTTI related to credit loss, which must be recognized in the income statement, and (2) OTTI related to other factors, which is recognized in other comprehensive income, net of applicable taxes. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the security.

### *Nonperforming and Past Due Loans*

Loans are placed on nonaccrual status when payment in full of principal or interest is not expected or upon which principal or interest has been in default for a period of 90 days or more unless the asset is both well secured and in the process of collection. If the decision is made to continue accruing interest on the loan, periodic reviews are made to confirm the accruing status of the loan. Nonaccrual loans and loans past due 90 days include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

When available information confirms that specific loans, or portions thereof, are uncollectible, these amounts are charged off against the allowance. All loan types are considered delinquent after 30 days past due and are typically charged off or charged down no later than 120 days past due, with consideration of, but not limited to, the following



criteria in determining the need and optional timing of the charge-off or charge-down: 1) the Bank is in the process of repossession or foreclosure and there appears to be a likely deficiency, 2) the collateral securing the loan has been sold and there is an actual deficiency, 3) the Bank is proceeding with lengthy legal action to collect its balance, 4) the borrower is unable to be located or 5) the borrower has filed bankruptcy. Events requiring charge-offs occur when a shortfall is identified between the recorded investment in the loan and the underlying value of the collateral.

#### *Allowance for Loan Losses*

The allowance for loan losses is a valuation allowance that is established through charges to earnings in the form of a provision for loan losses. The amount of the allowance for loan losses is affected by the following: (1) charge-off of loans that decrease the allowance, (2) subsequent recoveries on loans previously charged off that increase the allowance and (3) provisions for loan losses charged to earnings that increase the allowance.

Throughout the year, management estimates the probable incurred losses in the loan portfolio to determine if the allowance for loan losses is adequate to absorb such losses. The allowance for loan losses consists of specific and general components. The specific component relates to loans that are individually classified as impaired. We follow a loan review program to evaluate the credit risk in the loan portfolio. Loans that have been identified as impaired are reviewed on a quarterly basis in order to determine whether a specific reserve is required. The general component covers non-impaired loans and is based on industry and our specific historical loan loss experience, volume, growth and composition of the loan portfolio, the evaluation of our loan portfolio through our internal loan review process, general current economic conditions both internal and external to us that may affect the borrower's ability to pay, value of collateral and other qualitative relevant risk factors. Based on a review of these estimates, we adjust the allowance for loan losses to a level determined by management to be adequate. Estimates of loan losses are inherently subjective as they involve an exercise of judgment.

Our allowance for loan losses, both in dollars and as a percentage of total loans, may not be comparable to other similar sized institutions due to the impact of acquisition accounting. As part of acquisition accounting, acquired loans are initially recognized at fair value with no corresponding allowance for loan losses. Initial fair value of the loans includes consideration of expected credit losses.

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Loans for which the terms have been modified, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and therefore classified as impaired. Subsequent to identification as a troubled debt restructuring, such loans are then evaluated for impairment on an individual basis whereby we determine the amount of reserve in accordance with the accounting policy for the impaired loans as part of our allowance for loan losses calculation. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

### *Accounting for Acquired Loans*

At the time of an acquisition, we evaluate loans to determine if they are purchase credit impaired loans. Purchased credit impaired loans are those acquired loans with evidence of credit deterioration for which it was probable at acquisition that we would be unable to collect all contractual payments. We make this determination by considering past due and/or nonaccrual status, prior designation of a troubled debt restructuring, or other factors that may suggest we will not be able to collect all contractual payments. Purchased credit impaired loans are initially recorded at fair value with the difference between fair value and estimated future cash flows accreted over the expected cash flow period as income only to the extent we can reasonably estimate the timing and amount of future cash flows. In this case, these loans would be classified as accruing. In the event we are unable to reasonably estimate timing and amount of future cash flows, the loan is classified as non-accrual. An acquired loan previously classified by the seller as a troubled debt restructuring is no longer classified as such at the date of acquisition. Past due status is reported based on contractual payment status.

Our purchase credit impaired loans have generally been de minimis and comprised 0.1% of our loan portfolio at June 30, 2016. Historically, purchased credit impaired loans have been placed on nonaccrual status and reported as such until we were able to reasonably estimate the timing and amount of future expected cash flows. Income associated with purchased credit impaired loans for the three and six months ended June 30, 2016 and prior periods has been immaterial.

All loans not otherwise classified as purchase credit impaired are recorded at fair value with the discount to contractual value accreted over the life of the loan. When determining the allowance for loan losses on acquired loans, we bifurcate the allowance between legacy loans and acquired loans. Loans remain designated as acquired until either (i) loan is renewed or (ii) loan is substantially modified whereby modification results in a new loan. When determining the allowance on acquired loans, the Company estimates principal losses as compared to the Company's recorded investment, with the recorded investment being net of any unaccreted discounts from the acquisition. At June 30, 2016, we had \$226.6 million in acquired loans that have not been renewed or substantially modified, which is net of an unaccreted discount of \$1.4 million or 0.62%.

### *Goodwill*

Goodwill resulting from business combinations is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill is assessed annually for impairment or when events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Goodwill acquired in a purchase business combination that is determined to have an indefinite useful life, is not amortized, but tested for impairment. We perform our annual impairment test on October 1st. Goodwill is the only intangible asset with an indefinite life on our balance sheet.

### ***Recently Issued Accounting Pronouncements***

*ASU 2015-16, "Business Combinations (Topic 805) – Simplifying the Accounting for Measurement-Period Adjustments."* ASU 2015-16 requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The acquirer must record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. Additionally, the entity is required to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. The adoption of this ASU 2015-16 did not have a significant impact on the Company's financial statements.

*ASU 2014-09 "Revenue from Contract with Customers (Topic 606)."* ASU 2014-09 supersedes the revenue recognition requirements in Revenue Recognition (Topic 605), and most industry-specific guidance throughout the Industry Topics of the Codification. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 is currently effective for us beginning on January 1, 2018 with retrospective application to each prior reporting period presented. We are currently evaluating the potential impact of ASU 2014-09 on our financial statements.

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*ASU 2016-02 “Leases (Topic 842).”* ASU 2016-02 will, among other things, require lessees to recognize a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and 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. ASU 2016-02 does not significantly change lease accounting requirements applicable to lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model and ASC Topic 606, “Revenue from Contracts with Customers.” ASU 2016-02 will be effective for us beginning on January 1, 2019 and will require transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. We are currently evaluating the potential impact of ASU 2016-02 on our financial statements.

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

*ASU No. 2016-10, “Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing.”* ASU 2016-10 was issued to clarify ASC Topic 606, “Revenue from Contracts with Customers” related to (i) identifying performance obligations; and (ii) the licensing implementation guidance. The effective date and transition of ASU 2016-10 is the same as the effective date and transition of ASU 2014-09, “Revenue from Contracts with Customers (Topic 606),” as discussed above. We are currently evaluating the potential impact of ASU 2016-10 on our financial statements.

*ASU No. 2016-13, “Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.”* ASU 2016-13 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. ASU 2016-13 will be effective on January 1, 2020. We are currently evaluating the potential impact of ASU 2016-13 on our financial statements.

**Results of Operations**

Net income attributable to common stockholders was \$5.3 million (\$0.40 per diluted common share) for the three months ended June 30, 2016 compared with \$3.6 million (\$0.36 per diluted common share) for the three months ended June 30, 2015, an increase in net income attributable to common stockholders of \$1.6 million or 45.0%. Annualized returns on average common equity were 7.79% and 8.20%, annualized returns on average tangible common equity were 9.30% and 10.04%, annualized returns on average assets were 0.91% and 0.84%, and efficiency ratios were 60.11% and 64.90% for the three months ended June 30, 2016 and June 30, 2015, respectively. The efficiency ratio is calculated by dividing total noninterest expense by the sum of net interest income plus noninterest income, excluding net gains and losses on the sale of branch assets, loans and securities. Additionally, taxes and provision for loan losses are not part of this calculation.

Net income attributable to common stockholders was \$11.6 million (\$0.89 per diluted common share) for the six months ended June 30, 2016 compared with \$7.0 million (\$0.70 per diluted common share) for the six months ended June 30, 2015, an increase in net income attributable to common stockholders of \$4.6 million or 66.6%. This increase was primarily the result of the increase in average interest-earning assets due to organic growth within the loan portfolio and the increase in the securities portfolio. Additionally, net income increased partially due to the sale of two Central Texas branch locations during the first quarter 2016, resulting in after tax gain of \$1.3 million. Excluding the gain on the sale of the two Central Texas branch locations, net income attributable to common stockholders would have been \$10.3 million and net income per diluted common share would have been \$0.79 for the six months ended June 30, 2016. Annualized returns on average common equity were 8.74% and 7.47%, annualized returns on average tangible common equity were 10.46% and 9.83% and annualized returns on average assets were 1.04% and 0.80% for the six months ended June 30, 2016 and June 30, 2015, respectively. Excluding the gain on the sale of the two Central Texas branch locations, the average common equity, average tangible common equity and annualized returns on average assets for the six months ended June 30, 2016 would have been 7.73%, 9.26% and 0.92%, respectively. Our efficiency ratio was 61.93% and 66.99% for the six months ended June 30, 2016 and June 30, 2015, respectively.

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*Net Interest Income*

*Three months ended June 30, 2016 compared with three months ended June 30, 2015.* Net interest income before the provision for loan losses for the three months ended June 30, 2016 was \$21.9 million compared with \$19.7 million for the three months ended June 30, 2015, an increase of \$2.2 million, or 11.2%. The increase in net interest income was primarily due to the increase in average interest-earning assets of \$422.4 million or 25.3% for the three months ended June 30, 2016 compared with the three months ended June 30, 2015. This increase in average interest-earning assets during the three months ended June 30, 2016 as compared to the same period in 2015 was primarily due to organic loan growth and the increase in the securities portfolio.

Interest income was \$24.5 million for the three months ended June 30, 2016, an increase of \$2.7 million, or 12.3%, compared with the three months ended June 30, 2015, primarily due to an increase of \$1.8 million, or 8.3%, in interest income and fees on loans during the three months ended June 30, 2016 compared to the same period in 2015 as a result of the increase in average loans outstanding of \$245.6 million for the same period. Additionally, during the three months ended June 30, 2016 and June 30, 2015, we benefitted from acquisition accounting loan discount accretion of \$351 thousand and \$1.1 million, respectively.

Interest expense was \$2.6 million for the three months ended June 30, 2016, an increase of \$462 thousand compared to the three months ended June 30, 2015. This increase was primarily due to an increase in average interest-bearing liabilities of \$270.4 million for the three months ended June 30, 2016 compared to the three months ended June 30, 2015. This increase in average interest-bearing liabilities was primarily attributable to the increase in long-term borrowings of \$90.2 million, short-term borrowings of \$83.8 million and certificates and other time deposits of \$79.9 million.

Tax equivalent net interest margin, defined as net interest income adjusted for tax-free income divided by average interest-earning assets, for the three months ended June 30, 2016 was 4.32%, a decrease of 47 basis points compared to 4.79% for the three months ended June 30, 2015. Tax equivalent adjustments to net interest margin are the result of increasing income from tax-free securities by an amount equal to the taxes that would have been paid if the income were fully taxable based on a 35% federal tax rate, thus making tax-exempt yields comparable to taxable asset yields. The impact of net acquisition accounting adjustments of \$407 thousand and \$1.3 million on the tax equivalent net interest margin was an increase of 8 basis points and 30 basis points for the three months ended June 30, 2016 and June 30, 2015, respectively.

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The following table presents, for the periods indicated, the total dollar amount of average balances, interest income from average interest-earning assets and the annualized resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed in both dollars and rates. Any nonaccruing loans have been included in the table as loans carrying a zero yield.

	Three Months Ended June 30,			2015		
	2016			2015		
	Average Balance	Interest Earned/ Interest Paid	Average Yield/ Rate	Average Balance	Interest Earned/ Interest Paid	Average Yield/ Rate
	(Dollars in thousands)					
Assets						
Interest-Earning Assets:						
Loans <sup>(3)</sup>	\$1,724,346	\$22,839	5.33 %	\$1,478,752	\$21,079	5.72 %
Securities	270,619	1,538	2.29 %	127,882	721	2.26 %
Deposits in other financial institutions	96,358	150	0.62 %	62,247	50	0.32 %
Total interest-earning assets	2,091,323	\$24,527	4.72 %	1,668,881	\$21,850	5.25 %
Allowance for loan losses	(14,129 )			(9,265 )		
Noninterest-earning assets	236,857			195,341		
Total assets	\$2,314,051			\$1,854,957		
Liabilities and Stockholders' Equity						
Interest-Bearing Liabilities:						
Interest-bearing demand deposits	\$102,550	\$88	0.34 %	\$101,029	\$83	0.33 %
Money market and savings deposits	435,851					