

WEST BANCORPORATION INC

Form 10-Q

October 30, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934  
For the quarterly period ended September 30, 2015

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: 0-49677

WEST BANCORPORATION, INC.

(Exact Name of Registrant as Specified in its Charter)

IOWA

(State of Incorporation)

42-1230603

(I.R.S. Employer Identification No.)

1601 22nd Street, West Des Moines, Iowa

(Address of principal executive offices)

50266

(Zip Code)

Registrant's telephone number, including area code: (515) 222-2300

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☒ No ☐

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

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|                         |                       |                           |                                  |
|-------------------------|-----------------------|---------------------------|----------------------------------|
| Large accelerated filer | <input type="radio"/> | Accelerated filer         | <input checked="" type="radio"/> |
| Non-accelerated filer   | <input type="radio"/> | Smaller reporting company | <input type="radio"/>            |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

As of October 29, 2015, there were 16,064,435 shares of common stock, no par value, outstanding.

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WEST BANCORPORATION, INC.

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## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

## West Bancorporation, Inc. and Subsidiary

## Consolidated Balance Sheets

(unaudited)

| (in thousands, except share data)                                                                                                                         | September 30, 2015 | December 31, 2014 |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------|-------------------|
| <b>ASSETS</b>                                                                                                                                             |                    |                   |
| Cash and due from banks                                                                                                                                   | \$36,194           | \$27,936          |
| Federal funds sold                                                                                                                                        | 18,592             | 11,845            |
| Cash and cash equivalents                                                                                                                                 | 54,786             | 39,781            |
| Investment securities available for sale, at fair value                                                                                                   | 325,617            | 272,790           |
| Investment securities held to maturity, at amortized cost (fair value of \$51,260 and \$51,501 at September 30, 2015 and December 31, 2014, respectively) | 51,280             | 51,343            |
| Federal Home Loan Bank stock, at cost                                                                                                                     | 14,210             | 15,075            |
| Loans                                                                                                                                                     | 1,240,038          | 1,184,045         |
| Allowance for loan losses                                                                                                                                 | (14,660)           | (13,607)          |
| Loans, net                                                                                                                                                | 1,225,378          | 1,170,438         |
| Premises and equipment, net                                                                                                                               | 11,115             | 9,988             |
| Accrued interest receivable                                                                                                                               | 5,041              | 4,425             |
| Bank-owned life insurance                                                                                                                                 | 32,657             | 32,107            |
| Deferred tax assets, net                                                                                                                                  | 6,713              | 6,333             |
| Other assets                                                                                                                                              | 6,370              | 13,553            |
| Total assets                                                                                                                                              | \$1,733,167        | \$1,615,833       |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                                                               |                    |                   |
| <b>LIABILITIES</b>                                                                                                                                        |                    |                   |
| Deposits:                                                                                                                                                 |                    |                   |
| Noninterest-bearing demand                                                                                                                                | \$447,386          | \$362,827         |
| Interest-bearing demand                                                                                                                                   | 241,250            | 241,722           |
| Savings                                                                                                                                                   | 578,775            | 527,277           |
| Time of \$250,000 or more                                                                                                                                 | 13,622             | 18,985            |
| Other time                                                                                                                                                | 106,103            | 119,651           |
| Total deposits                                                                                                                                            | 1,387,136          | 1,270,462         |
| Federal funds purchased                                                                                                                                   | 2,660              | 2,975             |
| Short-term borrowings                                                                                                                                     | 59,000             | 66,000            |
| Subordinated notes                                                                                                                                        | 20,619             | 20,619            |
| Federal Home Loan Bank advances, net of discount                                                                                                          | 98,008             | 96,888            |
| Long-term debt                                                                                                                                            | 9,730              | 12,676            |
| Accrued expenses and other liabilities                                                                                                                    | 6,797              | 6,038             |
| Total liabilities                                                                                                                                         | 1,583,950          | 1,475,658         |
| <b>COMMITMENTS AND CONTINGENCIES (NOTE 8)</b>                                                                                                             |                    |                   |
| <b>STOCKHOLDERS' EQUITY</b>                                                                                                                               |                    |                   |
| Preferred stock, \$0.01 par value; authorized 50,000,000 shares; no shares issued and outstanding at September 30, 2015 and December 31, 2014             | —                  | —                 |

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Common stock, no par value; authorized 50,000,000 shares; 16,064,435  
and

16,018,734 shares issued and outstanding at September 30, 2015 and

December 31, 2014, respectively

Additional paid-in capital

Retained earnings

Accumulated other comprehensive income

Total stockholders' equity

Total liabilities and stockholders' equity

See Notes to Consolidated Financial Statements.

3,000

19,732

126,369

116

149,217

\$1,733,167

3,000

18,971

117,950

254

140,175

\$1,615,833

Table of ContentsWest Bancorporation, Inc. and Subsidiary  
Consolidated Statements of Income  
(unaudited)

|                                                     | Three Months Ended<br>September 30, |          | Nine Months Ended September<br>30, |          |
|-----------------------------------------------------|-------------------------------------|----------|------------------------------------|----------|
| (in thousands, except per share data)               | 2015                                | 2014     | 2015                               | 2014     |
| Interest income:                                    |                                     |          |                                    |          |
| Loans, including fees                               | \$13,313                            | \$11,934 | \$38,934                           | \$34,936 |
| Investment securities:                              |                                     |          |                                    |          |
| Taxable                                             | 1,017                               | 1,191    | 3,184                              | 3,793    |
| Tax-exempt                                          | 789                                 | 721      | 2,309                              | 2,095    |
| Federal funds sold                                  | 28                                  | 14       | 60                                 | 43       |
| Total interest income                               | 15,147                              | 13,860   | 44,487                             | 40,867   |
| Interest expense:                                   |                                     |          |                                    |          |
| Deposits                                            | 500                                 | 592      | 1,622                              | 1,851    |
| Federal funds purchased                             | 2                                   | 2        | 6                                  | 8        |
| Short-term borrowings                               | 5                                   | 3        | 32                                 | 15       |
| Subordinated notes                                  | 179                                 | 242      | 526                                | 588      |
| Federal Home Loan Bank advances                     | 698                                 | 660      | 2,095                              | 1,959    |
| Long-term debt                                      | 57                                  | 72       | 183                                | 233      |
| Total interest expense                              | 1,441                               | 1,571    | 4,464                              | 4,654    |
| Net interest income                                 | 13,706                              | 12,289   | 40,023                             | 36,213   |
| Provision for loan losses                           | 200                                 | 100      | 400                                | 250      |
| Net interest income after provision for loan losses | 13,506                              | 12,189   | 39,623                             | 35,963   |
| Noninterest income:                                 |                                     |          |                                    |          |
| Service charges on deposit accounts                 | 663                                 | 713      | 1,934                              | 2,106    |
| Debit card usage fees                               | 463                                 | 443      | 1,367                              | 1,306    |
| Trust services                                      | 302                                 | 363      | 944                                | 1,013    |
| Revenue from residential mortgage banking           | 45                                  | 457      | 132                                | 1,059    |
| Increase in cash value of bank-owned life insurance | 183                                 | 198      | 550                                | 534      |
| Realized investment securities gains, net           | —                                   | 210      | 47                                 | 716      |
| Other income                                        | 279                                 | 238      | 743                                | 759      |
| Total noninterest income                            | 1,935                               | 2,622    | 5,717                              | 7,493    |
| Noninterest expense:                                |                                     |          |                                    |          |
| Salaries and employee benefits                      | 4,056                               | 3,961    | 12,051                             | 12,059   |
| Occupancy                                           | 1,031                               | 1,072    | 3,090                              | 3,107    |
| Data processing                                     | 595                                 | 546      | 1,738                              | 1,626    |
| FDIC insurance                                      | 209                                 | 190      | 620                                | 561      |
| Other real estate owned                             | —                                   | 3        | —                                  | 398      |
| Professional fees                                   | 194                                 | 249      | 575                                | 734      |
| Director fees                                       | 226                                 | 183      | 642                                | 525      |
| Other expenses                                      | 1,238                               | 1,182    | 3,722                              | 3,742    |
| Total noninterest expense                           | 7,549                               | 7,386    | 22,438                             | 22,752   |
| Income before income taxes                          | 7,892                               | 7,425    | 22,902                             | 20,704   |
| Income taxes                                        | 2,466                               | 2,362    | 7,101                              | 6,502    |
| Net income                                          | \$5,426                             | \$5,063  | \$15,801                           | \$14,202 |

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|                                          |        |        |        |        |
|------------------------------------------|--------|--------|--------|--------|
| Basic earnings per common share          | \$0.34 | \$0.32 | \$0.98 | \$0.89 |
| Diluted earnings per common share        | \$0.34 | \$0.32 | \$0.98 | \$0.89 |
| Cash dividends declared per common share | \$0.16 | \$0.12 | \$0.46 | \$0.35 |

See Notes to Consolidated Financial Statements.

Table of ContentsWest Bancorporation, Inc. and Subsidiary  
Consolidated Statements of Comprehensive Income  
(unaudited)

|                                                                                                                                                                               | Three Months Ended September 30, |         | Nine Months Ended September 30, |          |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------|---------|---------------------------------|----------|
| (in thousands)                                                                                                                                                                | 2015                             | 2014    | 2015                            | 2014     |
| Net income                                                                                                                                                                    | \$5,426                          | \$5,063 | \$15,801                        | \$14,202 |
| Other comprehensive income (loss):                                                                                                                                            |                                  |         |                                 |          |
| Unrealized gains on securities for which a portion of an other than temporary impairment has been recorded in earnings:                                                       |                                  |         |                                 |          |
| Unrealized holding gains arising during the period                                                                                                                            | —                                | 225     | —                               | 583      |
| Less: reclassification adjustment for impairment losses realized in net income                                                                                                | —                                | —       | —                               | —        |
| Income tax (expense)                                                                                                                                                          | —                                | (86     | ) —                             | (222     |
| Other comprehensive income on available for sale securities with other than temporary impairment                                                                              | —                                | 139     | —                               | 361      |
| Unrealized gains (losses) on securities without other than temporary impairment:                                                                                              |                                  |         |                                 |          |
| Unrealized holding gains arising during the period                                                                                                                            | 1,765                            | 88      | 1,205                           | 7,473    |
| Less: reclassification adjustment for net gains realized in net income                                                                                                        | —                                | (210    | ) (47                           | ) (716   |
| Less: reclassification adjustment for amortization of net unrealized gains on securities transferred from available for sale to held to maturity, realized in interest income | (10                              | ) (3    | ) (29                           | ) (3     |
| Income tax benefit (expense)                                                                                                                                                  | (667                             | ) 48    | (429                            | ) (2,566 |
| Other comprehensive income (loss) on available for sale securities without other than temporary impairment                                                                    | 1,088                            | (77     | ) 700                           | 4,188    |
| Unrealized gains (losses) on derivatives arising during the period                                                                                                            | (735                             | ) 387   | (1,470                          | ) (2,386 |
| Less: reclassification adjustment for net loss on derivatives realized in net income                                                                                          | —                                | 73      | 74                              | 73       |
| Less: reclassification adjustment for amortization of derivative termination costs                                                                                            | 28                               | —       | 44                              | —        |
| Income tax benefit (expense)                                                                                                                                                  | 269                              | (175    | ) 514                           | 879      |

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|                                                  |         |         |          |          |   |
|--------------------------------------------------|---------|---------|----------|----------|---|
| Other comprehensive income (loss) on derivatives | (438    | ) 285   | (838     | ) (1,434 | ) |
| Total other comprehensive income (loss)          | 650     | 347     | (138     | ) 3,115  |   |
| Comprehensive income                             | \$6,076 | \$5,410 | \$15,663 | \$17,317 |   |

See Notes to Consolidated Financial Statements.

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West Bancorporation, Inc. and  
Subsidiary  
Consolidated Statements of  
Stockholders' Equity  
(unaudited)

|                                                                                                                    | Preferred | Common Stock |         | Additional | Retained  | Accumulated<br>Other<br>Comprehensive |           |
|--------------------------------------------------------------------------------------------------------------------|-----------|--------------|---------|------------|-----------|---------------------------------------|-----------|
| (in thousands, except share and<br>per share data)                                                                 | Stock     | Shares       | Amount  | Capital    | Earnings  | Income (Loss)                         | Total     |
| Balance, December 31, 2013                                                                                         | \$—       | 15,976,204   | \$3,000 | \$18,411   | \$105,752 | \$ (3,538 )                           | \$123,625 |
| Net income                                                                                                         | —         | —            | —       | —          | 14,202    | —                                     | 14,202    |
| Other comprehensive income,<br>net of tax                                                                          | —         | —            | —       | —          | —         | 3,115                                 | 3,115     |
| Cash dividends declared, \$0.35<br>per common share                                                                | —         | —            | —       | —          | (5,600 )  | —                                     | (5,600 )  |
| Stock-based compensation<br>costs                                                                                  | —         | —            | —       | 456        | —         | —                                     | 456       |
| Issuance of common stock<br>upon vesting of restricted<br>stock units, net of shares<br>withheld for payroll taxes | —         | 42,530       | —       | (189 )     | —         | —                                     | (189 )    |
| Excess tax benefits from<br>vesting of restricted stock units                                                      | —         | —            | —       | 116        | —         | —                                     | 116       |
| Balance, September 30, 2014                                                                                        | \$—       | 16,018,734   | \$3,000 | \$18,794   | \$114,354 | \$ (423 )                             | \$135,725 |
| Balance, December 31, 2014                                                                                         | \$—       | 16,018,734   | \$3,000 | \$18,971   | \$117,950 | \$ 254                                | \$140,175 |
| Net income                                                                                                         | —         | —            | —       | —          | 15,801    | —                                     | 15,801    |
| Other comprehensive (loss),<br>net of tax                                                                          | —         | —            | —       | —          | —         | (138 )                                | (138 )    |
| Cash dividends declared, \$0.46<br>per common share                                                                | —         | —            | —       | —          | (7,382 )  | —                                     | (7,382 )  |
| Stock-based compensation<br>costs                                                                                  | —         | —            | —       | 831        | —         | —                                     | 831       |
| Issuance of common stock<br>upon vesting of restricted<br>stock units, net of shares<br>withheld for payroll taxes | —         | 45,701       | —       | (225 )     | —         | —                                     | (225 )    |
| Excess tax benefits from<br>vesting of restricted stock units                                                      | —         | —            | —       | 155        | —         | —                                     | 155       |
| Balance, September 30, 2015                                                                                        | \$—       | 16,064,435   | \$3,000 | \$19,732   | \$126,369 | \$ 116                                | \$149,217 |

See Notes to Consolidated Financial Statements.



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West Bancorporation, Inc. and Subsidiary  
Consolidated Statements of Cash Flows  
(unaudited)

|                                                                                   | Nine Months Ended September 30, |           |
|-----------------------------------------------------------------------------------|---------------------------------|-----------|
| (in thousands)                                                                    | 2015                            | 2014      |
| Cash Flows from Operating Activities:                                             |                                 |           |
| Net income                                                                        | \$ 15,801                       | \$ 14,202 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                 |           |
| Provision for loan losses                                                         | 400                             | 250       |
| Net amortization and accretion                                                    | 2,718                           | 2,843     |
| (Gain) loss on disposition of premises and equipment                              | 4                               | (1)       |
| Investment securities gains, net                                                  | (47)                            | (716)     |
| Stock-based compensation                                                          | 831                             | 456       |
| Gain on sale of loans held for sale                                               | (14)                            | (954)     |
| Proceeds from sales of loans held for sale                                        | 840                             | 49,250    |
| Originations of loans held for sale                                               | —                               | (46,409)  |
| Gain on sales of other real estate owned                                          | —                               | (21)      |
| Write-down of other real estate owned                                             | —                               | 346       |
| Increase in cash value of bank-owned life insurance                               | (550)                           | (534)     |
| Depreciation                                                                      | 700                             | 623       |
| Deferred income taxes                                                             | (295)                           | (84)      |
| Excess tax benefits from vesting of restricted stock units                        | (155)                           | (116)     |
| Change in assets and liabilities:                                                 |                                 |           |
| Increase in accrued interest receivable                                           | (616)                           | (542)     |
| Decrease in other assets                                                          | 2,902                           | 1,687     |
| Increase (decrease) in accrued expenses and other liabilities                     | (95)                            | 1,070     |
| Net cash provided by operating activities                                         | 22,424                          | 21,350    |
| Cash Flows from Investing Activities:                                             |                                 |           |
| Proceeds from sales of securities available for sale                              | 16,946                          | 36,582    |
| Proceeds from maturities and calls of securities available for sale               | 36,899                          | 43,478    |
| Purchases of securities available for sale                                        | (106,971)                       | (67,770)  |
| Purchases of Federal Home Loan Bank stock                                         | (15,827)                        | (12,448)  |
| Proceeds from redemption of Federal Home Loan Bank stock                          | 16,692                          | 10,335    |
| Net increase in loans                                                             | (55,340)                        | (92,438)  |
| Proceeds from sales of other real estate owned                                    | —                               | 1,363     |
| Proceeds from sales of premises and equipment                                     | —                               | 13        |
| Purchases of premises and equipment                                               | (1,831)                         | (3,757)   |
| Purchase of bank-owned life insurance                                             | —                               | (5,000)   |
| Proceeds from settlement of other assets                                          | 3,593                           | —         |
| Net cash (used in) investing activities                                           | (105,839)                       | (89,642)  |
| Cash Flows from Financing Activities:                                             |                                 |           |
| Net increase in deposits                                                          | 116,674                         | 41,420    |
| Net decrease in federal funds purchased                                           | (315)                           | (12,752)  |
| Net increase (decrease) in short-term borrowings                                  | (7,000)                         | 40,000    |
| Principal payments on long-term debt                                              | (2,946)                         | (2,444)   |
| Interest rate swap termination costs paid                                         | (541)                           | —         |
| Common stock dividends paid                                                       | (7,382)                         | (5,600)   |

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|                                                            |          |          |   |
|------------------------------------------------------------|----------|----------|---|
| Restricted stock units withheld for payroll taxes          | (225     | ) (189   | ) |
| Excess tax benefits from vesting of restricted stock units | 155      | 116      |   |
| Net cash provided by financing activities                  | 98,420   | 60,551   |   |
| Net increase (decrease) in cash and cash equivalents       | 15,005   | (7,741   | ) |
| Cash and Cash Equivalents:                                 |          |          |   |
| Beginning                                                  | 39,781   | 42,425   |   |
| Ending                                                     | \$54,786 | \$34,684 |   |

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West Bancorporation, Inc. and Subsidiary  
Consolidated Statements of Cash Flows (continued)  
(unaudited)

|                                                                        | Nine Months Ended September 30, |         |
|------------------------------------------------------------------------|---------------------------------|---------|
| (in thousands)                                                         | 2015                            | 2014    |
| Supplemental Disclosures of Cash Flow Information:                     |                                 |         |
| Cash payments for:                                                     |                                 |         |
| Interest                                                               | \$4,493                         | \$4,628 |
| Income taxes                                                           | 4,110                           | 3,650   |
| Supplemental Disclosure of Noncash Investing and Financing Activities: |                                 |         |
| Transfer of loans to other real estate owned                           | —                               | 394     |
| See Notes to Consolidated Financial Statements.                        |                                 |         |

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West Bancorporation, Inc. and Subsidiary  
Notes to Consolidated Financial Statements  
(unaudited)  
(in thousands, except per share data)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared by West Bancorporation, Inc. (the Company) pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to such rules and regulations. Although management believes that the disclosures are adequate to make the information presented understandable, it is suggested that these interim consolidated financial statements be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2014. In the opinion of management, the accompanying consolidated financial statements contain all adjustments necessary to fairly present the financial position as of September 30, 2015 and December 31, 2014, net income and comprehensive income for the three and nine months ended September 30, 2015 and 2014, and cash flows for the nine months ended September 30, 2015 and 2014. The results for these interim periods may not be indicative of results for the entire year or for any other period.

The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) established by the Financial Accounting Standards Board (FASB). References to GAAP issued by the FASB in these footnotes are to the FASB Accounting Standards Codification™, sometimes referred to as the Codification or ASC. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses for the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term are the fair value and other than temporary impairment (OTTI) of financial instruments, and the allowance for loan losses.

The accompanying unaudited consolidated financial statements include the accounts of the Company, West Bank and West Bank's wholly-owned subsidiary WB Funding Corporation (which owns an interest in a limited liability company). West Bank's 99.99 percent owned subsidiary ICD IV, LLC (a community development entity) was liquidated during the third quarter of 2014 because the underlying loan matured. All significant intercompany transactions and balances have been eliminated in consolidation. In accordance with GAAP, West Bancorporation Capital Trust I is recorded on the books of the Company using the equity method of accounting and is not consolidated.

Reclassification: Certain amounts in prior year financial statements have been reclassified, with no effect on net income, comprehensive income or stockholders' equity, to conform with current period presentation.

Current accounting developments: In January 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-04, Receivables—Troubled Debt Restructuring by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure. The update clarifies when an in substance foreclosure occurs, that is, when a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan. This is the point when the consumer mortgage loan should be derecognized and the real property recognized. For public companies, this update was effective for interim and annual periods beginning after December 31, 2014. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 660): Summary and Amendments that Create Revenue from Contracts with Customers (Topic 606) and Other Assets and Deferred Costs—Contracts with Customers (Subtopic 340-40). The guidance in this update supersedes the revenue recognition requirements in ASC Topic 605, Revenue Recognition, and most industry-specific guidance throughout the industry topics of the codification. For public companies, this update is effective for interim and annual periods beginning after December 15, 2017. The Company is currently assessing the impact that this guidance will have on its consolidated financial statements, but does not expect the guidance to have a material impact on the Company's consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The update simplifies the presentation of debt issuance costs by requiring that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of debt liability, consistent with debt discounts or premiums. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this update. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2015, and is to be applied retrospectively. Early adoption is permitted. The Company has determined that this guidance will not have a material impact on the Company's consolidated financial statements.

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## 2. Earnings per Common Share

Basic earnings per common share are computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted earnings per common share reflect the potential dilution that could occur if the Company's outstanding restricted stock units were vested. The dilutive effect was computed using the treasury stock method, which assumes all stock-based awards were exercised and the hypothetical proceeds from exercise were used by the Company to purchase common stock at the average market price during the period. The incremental shares, to the extent they would have been dilutive, were included in the denominator of the diluted earnings per common share calculation. The calculations of earnings per common share and diluted earnings per common share for the three and nine months ended September 30, 2015 and 2014 are presented in the following table.

|                                                               | Three Months Ended September 30, |         | Nine Months Ended September 30, |          |
|---------------------------------------------------------------|----------------------------------|---------|---------------------------------|----------|
|                                                               | 2015                             | 2014    | 2015                            | 2014     |
| Net income                                                    | \$5,426                          | \$5,063 | \$15,801                        | \$14,202 |
| Weighted average common shares outstanding                    | 16,062                           | 16,016  | 16,045                          | 15,999   |
| Weighted average effect of restricted stock units outstanding | 38                               | 24      | 47                              | 39       |
| Diluted weighted average common shares outstanding            | 16,100                           | 16,040  | 16,092                          | 16,038   |
| Basic earnings per common share                               | \$0.34                           | \$0.32  | \$0.98                          | \$0.89   |
| Diluted earnings per common share                             | \$0.34                           | \$0.32  | \$0.98                          | \$0.89   |

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## 3. Investment Securities

The following tables show the amortized cost, gross unrealized gains and losses and fair value of investment securities, by investment security type as of September 30, 2015 and December 31, 2014.

| September 30, 2015                                 |                   |                              |                                 |               |
|----------------------------------------------------|-------------------|------------------------------|---------------------------------|---------------|
|                                                    | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>(Losses) | Fair<br>Value |
| Securities available for sale:                     |                   |                              |                                 |               |
| U.S. government agencies and corporations          | \$2,558           | \$171                        | \$—                             | \$2,729       |
| State and political subdivisions                   | 61,610            | 1,080                        | (150)                           | ) 62,540      |
| Collateralized mortgage obligations <sup>(1)</sup> | 141,789           | 942                          | (525)                           | ) 142,206     |
| Mortgage-backed securities <sup>(1)</sup>          | 106,391           | 757                          | (199)                           | ) 106,949     |
| Trust preferred security                           | 1,770             | —                            | (734)                           | ) 1,036       |
| Corporate notes and equity securities              | 10,146            | 42                           | (31)                            | ) 10,157      |
|                                                    | \$324,264         | \$2,992                      | \$(1,639)                       | ) \$325,617   |
| Securities held to maturity:                       |                   |                              |                                 |               |
| State and political subdivisions                   | \$51,280          | \$276                        | \$(296)                         | ) \$51,260    |
| December 31, 2014                                  |                   |                              |                                 |               |
|                                                    | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>(Losses) | Fair<br>Value |
| Securities available for sale:                     |                   |                              |                                 |               |
| U.S. government agencies and corporations          | \$12,626          | \$204                        | \$(10)                          | ) \$12,820    |
| State and political subdivisions                   | 51,234            | 1,286                        | (161)                           | ) 52,359      |
| Collateralized mortgage obligations <sup>(1)</sup> | 126,430           | 856                          | (1,416)                         | ) 125,870     |
| Mortgage-backed securities <sup>(1)</sup>          | 65,813            | 624                          | (284)                           | ) 66,153      |
| Trust preferred security                           | 1,763             | —                            | (845)                           | ) 918         |
| Corporate notes and equity securities              | 14,729            | 66                           | (125)                           | ) 14,670      |
|                                                    | \$272,595         | \$3,036                      | \$(2,841)                       | ) \$272,790   |
| Securities held to maturity:                       |                   |                              |                                 |               |
| State and political subdivisions                   | \$51,343          | \$344                        | \$(186)                         | ) \$51,501    |

All collateralized mortgage obligations and mortgage-backed securities consist of residential mortgage

(1) pass-through securities guaranteed by GNMA or issued by FNMA and real estate mortgage investment conduits guaranteed by FHLMC or GNMA.

Investment securities with an amortized cost of approximately \$79,525 and \$4,805 as of September 30, 2015 and December 31, 2014, respectively, were pledged to secure access to the Federal Reserve discount window, for public fund deposits, and for other purposes as required or permitted by law or regulation. The increase in the amount of pledged investment securities at September 30, 2015 compared to December 31, 2014 was primarily due to an

increase in public fund deposits.

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The amortized cost and fair value of investment securities available for sale as of September 30, 2015, by contractual maturity, are shown below. Certain securities have call features that allow the issuer to call the securities prior to maturity. Expected maturities may differ from contractual maturities for collateralized mortgage obligations and mortgage-backed securities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Therefore, collateralized mortgage obligations and mortgage-backed securities are not included in the maturity categories within the following maturity summary. Equity securities have no maturity date.

|                                                                    | September 30, 2015 |            |
|--------------------------------------------------------------------|--------------------|------------|
|                                                                    | Amortized Cost     | Fair Value |
| Due in one year or less                                            | \$1,007            | \$1,025    |
| Due after one year through five years                              | 19,002             | 19,424     |
| Due after five years through ten years                             | 23,138             | 23,521     |
| Due after ten years                                                | 31,453             | 31,025     |
|                                                                    | 74,600             | 74,995     |
| Collateralized mortgage obligations and mortgage-backed securities | 248,180            | 249,155    |
| Equity securities                                                  | 1,484              | 1,467      |
|                                                                    | \$324,264          | \$325,617  |

The amortized cost and fair value of investment securities held to maturity as of September 30, 2015, by contractual maturity, are shown below. Certain securities have call features that allow the issuer to call the securities prior to maturity.

|                                        | September 30, 2015 |            |
|----------------------------------------|--------------------|------------|
|                                        | Amortized Cost     | Fair Value |
| Due after one year through five years  | \$277              | \$273      |
| Due after five years through ten years | 14,393             | 14,414     |
| Due after ten years                    | 36,610             | 36,573     |
|                                        | \$51,280           | \$51,260   |

The details of the sales of investment securities for the three and nine months ended September 30, 2015 and 2014 are summarized in the following table.

|                       | Three Months Ended September 30, |         | Nine Months Ended September 30, |          |
|-----------------------|----------------------------------|---------|---------------------------------|----------|
|                       | 2015                             | 2014    | 2015                            | 2014     |
| Proceeds from sales   | \$—                              | \$7,344 | \$16,946                        | \$36,582 |
| Gross gains on sales  | —                                | 334     | 54                              | 1,050    |
| Gross losses on sales | —                                | 124     | 7                               | 334      |

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The following tables show the fair value and gross unrealized losses, aggregated by investment type and length of time that individual securities have been in a continuous loss position, as of September 30, 2015 and December 31, 2014.

|                                           | September 30, 2015  |                           |                     |                           | Total      |                           |
|-------------------------------------------|---------------------|---------------------------|---------------------|---------------------------|------------|---------------------------|
|                                           | Less than 12 months |                           | 12 months or longer |                           |            |                           |
|                                           | Fair Value          | Gross Unrealized (Losses) | Fair Value          | Gross Unrealized (Losses) | Fair Value | Gross Unrealized (Losses) |
| Securities available for sale:            |                     |                           |                     |                           |            |                           |
| U.S. government agencies and corporations | \$—                 | \$—                       | \$—                 | \$—                       | \$—        | \$—                       |
| State and political subdivisions          | 11,928              | (101 )                    | 2,026               | (49 )                     | 13,954     | (150 )                    |
| Collateralized mortgage obligations       | 20,423              | (35 )                     | 40,157              | (490 )                    | 60,580     | (525 )                    |
| Mortgage-backed securities                | 60,434              | (155 )                    | 7,533               | (44 )                     | 67,967     | (199 )                    |
| Trust preferred security                  | —                   | —                         | 1,036               | (734 )                    | 1,036      | (734 )                    |
| Corporate notes and equity securities     | 4,040               | (20 )                     | 481                 | (11 )                     | 4,521      | (31 )                     |
|                                           | \$96,825            | \$(311 )                  | \$51,233            | \$(1,328 )                | \$148,058  | \$(1,639 )                |
| Securities held to maturity:              |                     |                           |                     |                           |            |                           |
| State and political subdivisions          | \$12,420            | \$(145 )                  | \$6,063             | \$(151 )                  | \$18,483   | \$(296 )                  |

|                                           | December 31, 2014   |                           |                     |                           | Total      |                           |
|-------------------------------------------|---------------------|---------------------------|---------------------|---------------------------|------------|---------------------------|
|                                           | Less than 12 months |                           | 12 months or longer |                           |            |                           |
|                                           | Fair Value          | Gross Unrealized (Losses) | Fair Value          | Gross Unrealized (Losses) | Fair Value | Gross Unrealized (Losses) |
| Securities available for sale:            |                     |                           |                     |                           |            |                           |
| U.S. government agencies and corporations | \$10,039            | \$(10 )                   | \$—                 | \$—                       | \$10,039   | \$(10 )                   |
| State and political subdivisions          | 6,614               | (90 )                     | 5,887               | (71 )                     | 12,501     | (161 )                    |
| Collateralized mortgage obligations       | 17,283              | (87 )                     | 53,318              | (1,329 )                  | 70,601     | (1,416 )                  |
| Mortgage-backed securities                | 15,184              | (101 )                    | 17,126              | (183 )                    | 32,310     | (284 )                    |
| Trust preferred security                  | —                   | —                         | 918                 | (845 )                    | 918        | (845 )                    |
| Corporate notes and equity securities     | 4,581               | (23 )                     | 2,881               | (102 )                    | 7,462      | (125 )                    |
|                                           | \$53,701            | \$(311 )                  | \$80,130            | \$(2,530 )                | \$133,831  | \$(2,841 )                |
| Securities held to maturity:              |                     |                           |                     |                           |            |                           |
| State and political subdivisions          | \$13,048            | \$(186 )                  | \$—                 | \$—                       | \$13,048   | \$(186 )                  |

As of September 30, 2015, the available for sale and held to maturity securities with unrealized losses that have existed for longer than one year included 18 state and political subdivision securities, 11 collateralized mortgage obligation securities, two mortgage-backed securities, one trust preferred security and one equity security.

The Company believes the unrealized losses on investments available for sale and held to maturity as of September 30, 2015, were due to market conditions, rather than reduced estimated cash flows. The Company does not intend to sell these securities, does not anticipate that these securities will be required to be sold before anticipated recovery, and expects full principal and interest to be collected. Therefore, the Company does not consider these investments to have OTTI as of September 30, 2015.

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## 4. Loans and Allowance for Loan Losses

Loans consisted of the following segments as of September 30, 2015 and December 31, 2014.

|                                         | September 30, 2015 | December 31, 2014 |
|-----------------------------------------|--------------------|-------------------|
| Commercial                              | \$ 347,598         | \$ 316,908        |
| Real estate:                            |                    |                   |
| Construction, land and land development | 168,831            | 154,490           |
| 1-4 family residential first mortgages  | 51,156             | 53,497            |
| Home equity                             | 22,147             | 24,500            |
| Commercial                              | 643,588            | 625,938           |
| Consumer and other loans                | 7,628              | 9,318             |
|                                         | 1,240,948          | 1,184,651         |
| Net unamortized fees and costs          | (910)              | (606)             |
|                                         | \$ 1,240,038       | \$ 1,184,045      |

Real estate loans of approximately \$590,000 were pledged as security for Federal Home Loan Bank (FHLB) advances as of September 30, 2015 and December 31, 2014.

Loans are stated at the principal amounts outstanding, net of unamortized loan fees and costs, with interest income recognized on the interest method based upon those outstanding loan balances. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method. Loans are reported by the portfolio segments identified above and are analyzed by management on this basis. All loan policies identified below apply to all segments of the loan portfolio.

Delinquencies are determined based on the payment terms of the individual loan agreements. The accrual of interest on past due and other impaired loans is generally discontinued at 90 days past due or when, in the opinion of management, the borrower may be unable to make all payments pursuant to contractual terms. Unless considered collectible, all interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income, if accrued in the current year, or charged to the allowance for loan losses, if accrued in the prior year. Generally, all payments received while a loan is on nonaccrual status are applied to the principal balance of the loan. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Based upon its ongoing assessment of credit quality within the loan portfolio, the Company maintains a Watch List, which includes loans classified as Doubtful, Substandard and Watch according to the Company's classification criteria. These loans involve the potential for payment defaults or collateral inadequacies. A loan on the Watch List is considered impaired when management believes it is probable the Company will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. The amount of impairment, if any, and any subsequent changes are included in the allowance for loan losses.

A loan is classified as a troubled debt restructured (TDR) loan when the Company concludes that a borrower is experiencing financial difficulties and a concession was granted that would not otherwise be considered. Concessions may include a restructuring of the loan terms to alleviate the burden on the borrower's cash requirements, such as an extension of the payment terms beyond the original maturity date or a change in the interest rate charged. TDR loans with extended payment terms are accounted for as impaired until performance is established. A change to the interest rate would change the classification of a loan to a TDR loan if the restructured loan yields a rate that is below a market rate for that of a new loan with comparable risk. TDR loans with below-market rates are considered impaired until fully collected. TDR loans may also be reported as nonaccrual or past due 90 days if they are not performing per the restructured terms.

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The table below presents the TDR loans by segment as of September 30, 2015 and December 31, 2014.

|                                                   | September 30, 2015 | December 31, 2014 |
|---------------------------------------------------|--------------------|-------------------|
| Troubled debt restructured loans <sup>(1)</sup> : |                    |                   |
| Commercial                                        | \$ 107             | \$—               |
| Real estate:                                      |                    |                   |
| Construction, land and land development           | 158                | 376               |
| 1-4 family residential first mortgages            | 92                 | 86                |
| Home equity                                       | —                  | —                 |
| Commercial                                        | 473                | 557               |
| Consumer and other loans                          | —                  | —                 |
| Total troubled debt restructured loans            | \$830              | \$1,019           |

- (1) There were three TDR loans as of September 30, 2015 and two TDR loans as of December 31, 2014, with balances of \$652 and \$643, respectively, categorized as nonaccrual.

There were no loan modifications considered to be TDR that occurred during the three months ended September 30, 2015, and two loan modifications considered to be TDR that occurred during the nine months ended September 30, 2015 with a pre- and post-modification recorded investment totaling \$130. There were no loan modifications considered to be TDR that occurred during the three and nine months ended September 30, 2014.

One TDR loan that was modified within the twelve months preceding September 30, 2015, with a recorded investment of \$107, has subsequently had a payment default. No TDR loans that were modified within the twelve months preceding September 30, 2014 have subsequently had a payment default. A TDR loan is considered to have a payment default when it is past due 30 days or more.

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The following table summarizes the recorded investment in impaired loans by segment, broken down by loans with no related allowance and loans with a related allowance and the amount of that allowance as of September 30, 2015 and December 31, 2014.

|                                         | September 30, 2015  |                          |                   | December 31, 2014   |                          |                   |
|-----------------------------------------|---------------------|--------------------------|-------------------|---------------------|--------------------------|-------------------|
|                                         | Recorded Investment | Unpaid Principal Balance | Related Allowance | Recorded Investment | Unpaid Principal Balance | Related Allowance |
| With no related allowance recorded:     |                     |                          |                   |                     |                          |                   |
| Commercial                              | \$—                 | \$—                      | \$—               | \$164               | \$310                    | \$—               |
| Real Estate:                            |                     |                          |                   |                     |                          |                   |
| Construction, land and land development | 158                 | 760                      | —                 | 376                 | 978                      | —                 |
| 1-4 family residential first mortgages  | 371                 | 371                      | —                 | 257                 | 257                      | —                 |
| Home equity                             | —                   | —                        | —                 | —                   | —                        | —                 |
| Commercial                              | 510                 | 510                      | —                 | 557                 | 557                      | —                 |
| Consumer and other loans                | 4                   | 4                        | —                 | —                   | —                        | —                 |
|                                         | 1,043               | 1,645                    | —                 | 1,354               | 2,102                    | —                 |
| With an allowance recorded:             |                     |                          |                   |                     |                          |                   |
| Commercial                              | 147                 | 147                      | 147               | 292                 | 292                      | 150               |
| Real Estate:                            |                     |                          |                   |                     |                          |                   |
| Construction, land and land development | —                   | —                        | —                 | 825                 | 825                      | 200               |
| 1-4 family residential first mortgages  | —                   | —                        | —                 | —                   | —                        | —                 |
| Home equity                             | 274                 | 274                      | 274               | 229                 | 229                      | 229               |
| Commercial                              | 160                 | 160                      | 160               | 172                 | 172                      | 172               |
| Consumer and other loans                | —                   | —                        | —                 | —                   | —                        | —                 |
|                                         | 581                 | 581                      | 581               | 1,518               | 1,518                    | 751               |
| Total:                                  |                     |                          |                   |                     |                          |                   |
| Commercial                              | 147                 | 147                      | 147               | 456                 | 602                      | 150               |
| Real Estate:                            |                     |                          |                   |                     |                          |                   |
| Construction, land and land development | 158                 | 760                      | —                 | 1,201               | 1,803                    | 200               |
| 1-4 family residential first mortgages  | 371                 | 371                      | —                 | 257                 | 257                      | —                 |
| Home equity                             | 274                 | 274                      | 274               | 229                 | 229                      | 229               |
| Commercial                              | 670                 | 670                      | 160               | 729                 | 729                      | 172               |
| Consumer and other loans                | 4                   | 4                        | —                 | —                   | —                        | —                 |
|                                         | \$1,624             | \$2,226                  | \$581             | \$2,872             | \$3,620                  | \$751             |

The balance of impaired loans at September 30, 2015 and December 31, 2014 was composed of 13 and 11 different borrowers, respectively. The Company has no commitments to advance additional funds on any of the impaired loans.



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The following table summarizes the average recorded investment and interest income recognized on impaired loans by segment for the three and nine months ended September 30, 2015 and 2014.

|                                         | Three Months Ended September 30,<br>2015 |                                  | 2014                              |                                  | Nine Months Ended September 30,<br>2015 |                                  | 2014                              |                                  |
|-----------------------------------------|------------------------------------------|----------------------------------|-----------------------------------|----------------------------------|-----------------------------------------|----------------------------------|-----------------------------------|----------------------------------|
|                                         | Average<br>Recorded<br>Investment        | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment       | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| With no related allowance recorded:     |                                          |                                  |                                   |                                  |                                         |                                  |                                   |                                  |
| Commercial                              | \$ 132                                   | \$ —                             | \$ 165                            | \$ —                             | \$ 151                                  | \$ —                             | \$ 303                            | \$ —                             |
| Real estate:                            |                                          |                                  |                                   |                                  |                                         |                                  |                                   |                                  |
| Construction, land and land development | 255                                      | 3                                | 394                               | 3                                | 319                                     | 10                               | 403                               | 11                               |
| 1-4 family residential first mortgages  | 316                                      | —                                | 302                               | —                                | 295                                     | —                                | 378                               | 7                                |
| Home equity                             | —                                        | —                                | 22                                | —                                | —                                       | —                                | 9                                 | —                                |
| Commercial                              | 1,565                                    | —                                | 663                               | —                                | 1,088                                   | —                                | 708                               | 3                                |
| Consumer and other loans                | 3                                        | —                                | —                                 | —                                | 3                                       | —                                | —                                 | —                                |
|                                         | 2,271                                    | 3                                | 1,546                             | 3                                | 1,856                                   | 10                               | 1,801                             | 21                               |
| With an allowance recorded:             |                                          |                                  |                                   |                                  |                                         |                                  |                                   |                                  |
| Commercial                              | 146                                      | —                                | 573                               | 2                                | 222                                     | 2                                | 566                               | 7                                |
| Real estate:                            |                                          |                                  |                                   |                                  |                                         |                                  |                                   |                                  |
| Construction, land and land development | —                                        | —                                | 1,150                             | 13                               | 247                                     | 6                                | 1,562                             | 54                               |
| 1-4 family residential first mortgages  | —                                        | —                                | —                                 | —                                | —                                       | —                                | 187                               | —                                |
| Home equity                             | 231                                      | —                                | 236                               | —                                | 227                                     | —                                | 94                                | —                                |
| Commercial                              | 161                                      | —                                | 44                                | —                                | 166                                     | —                                | 18                                | —                                |
| Consumer and other loans                | —                                        | —                                | —                                 | —                                | —                                       | —                                | —                                 | —                                |
|                                         | 538                                      | —                                | 2,003                             | 15                               | 862                                     | 8                                | 2,427                             | 61                               |
| Total:                                  |                                          |                                  |                                   |                                  |                                         |                                  |                                   |                                  |
| Commercial                              | 278                                      | —                                | 738                               | 2                                | 373                                     | 2                                | 869                               | 7                                |
| Real estate:                            |                                          |                                  |                                   |                                  |                                         |                                  |                                   |                                  |
| Construction, land and land development | 255                                      | 3                                | 1,544                             | 16                               | 566                                     | 16                               | 1,965                             | 65                               |
| 1-4 family residential first            |                                          |                                  |                                   |                                  |                                         |                                  |                                   |                                  |

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|                             |         |      |         |       |         |       |         |       |
|-----------------------------|---------|------|---------|-------|---------|-------|---------|-------|
| mortgages                   | 316     | —    | 302     | —     | 295     | —     | 565     | 7     |
| Home equity                 | 231     | —    | 258     | —     | 227     | —     | 103     | —     |
| Commercial                  | 1,726   | —    | 707     | —     | 1,254   | —     | 726     | 3     |
| Consumer and other<br>loans | 3       | —    | —       | —     | 3       | —     | —       | —     |
|                             | \$2,809 | \$ 3 | \$3,549 | \$ 18 | \$2,718 | \$ 18 | \$4,228 | \$ 82 |

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The following tables provide an analysis of the payment status of the recorded investment in loans as of September 30, 2015 and December 31, 2014.

|                                            | September 30, 2015        |                           |                                | Total<br>Past Due | Current     | Nonaccrual<br>Loans | Total Loans    |
|--------------------------------------------|---------------------------|---------------------------|--------------------------------|-------------------|-------------|---------------------|----------------|
|                                            | 30-59<br>Days Past<br>Due | 60-89<br>Days Past<br>Due | 90 Days<br>or More<br>Past Due |                   |             |                     |                |
| Commercial                                 | \$50                      | \$—                       | \$—                            | \$50              | \$347,401   | \$147               | \$347,598      |
| Real estate:                               |                           |                           |                                |                   |             |                     |                |
| Construction, land and<br>land development | —                         | —                         | —                              | —                 | 168,831     | —                   | 168,831        |
| 1-4 family residential<br>first mortgages  | 339                       | —                         | —                              | 339               | 50,466      | 351                 | 51,156         |
| Home equity                                | —                         | —                         | —                              | —                 | 21,873      | 274                 | 22,147         |
| Commercial                                 | —                         | —                         | —                              | —                 | 642,918     | 670                 | 643,588        |
| Consumer and other                         | —                         | —                         | —                              | —                 | 7,624       | 4                   | 7,628          |
| Total                                      | \$389                     | \$—                       | \$—                            | \$389             | \$1,239,113 | \$1,446             | \$1,240,948    |
|                                            | December 31, 2014         |                           |                                | Total<br>Past Due | Current     | Nonaccrual<br>Loans | Total<br>Loans |
|                                            | 30-59<br>Days Past<br>Due | 60-89<br>Days Past<br>Due | 90 Days<br>or More<br>Past Due |                   |             |                     |                |
| Commercial                                 | \$34                      | \$—                       | \$—                            | \$34              | \$316,528   | \$346               | \$316,908      |
| Real estate:                               |                           |                           |                                |                   |             |                     |                |
| Construction, land and<br>land development | —                         | —                         | —                              | —                 | 154,490     | —                   | 154,490        |
| 1-4 family residential<br>first mortgages  | —                         | —                         | —                              | —                 | 53,240      | 257                 | 53,497         |
| Home equity                                | 14                        | —                         | —                              | 14                | 24,257      | 229                 | 24,500         |
| Commercial                                 | 1,500                     | —                         | —                              | 1,500             | 623,709     | 729                 | 625,938        |
| Consumer and other                         | —                         | —                         | —                              | —                 | 9,318       | —                   | 9,318          |
| Total                                      | \$1,548                   | \$—                       | \$—                            | \$1,548           | \$1,181,542 | \$1,561             | \$1,184,651    |

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The following tables present the recorded investment in loans by credit quality indicator and loan segment as of September 30, 2015 and December 31, 2014.

|                                         | September 30, 2015 |          |             |          |             |
|-----------------------------------------|--------------------|----------|-------------|----------|-------------|
|                                         | Pass               | Watch    | Substandard | Doubtful | Total       |
| Commercial                              | \$341,815          | \$5,386  | \$397       | \$—      | \$347,598   |
| Real estate:                            |                    |          |             |          |             |
| Construction, land and land development | 166,783            | 852      | 1,196       | —        | 168,831     |
| 1-4 family residential first mortgages  | 50,136             | 522      | 498         | —        | 51,156      |
| Home equity                             | 21,793             | 68       | 286         | —        | 22,147      |
| Commercial                              | 616,901            | 25,199   | 1,488       | —        | 643,588     |
| Consumer and other                      | 7,609              | —        | 19          | —        | 7,628       |
| Total                                   | \$1,205,037        | \$32,027 | \$3,884     | \$—      | \$1,240,948 |
|                                         | December 31, 2014  |          |             |          |             |
|                                         | Pass               | Watch    | Substandard | Doubtful | Total       |
| Commercial                              | \$309,704          | \$6,268  | \$936       | \$—      | \$316,908   |
| Real estate:                            |                    |          |             |          |             |
| Construction, land and land development | 151,258            | 993      | 2,239       | —        | 154,490     |
| 1-4 family residential first mortgages  | 52,574             | 536      | 387         | —        | 53,497      |
| Home equity                             | 23,958             | 218      | 324         | —        | 24,500      |
| Commercial                              | 614,974            | 7,467    | 3,497       | —        | 625,938     |
| Consumer and other                      | 9,318              | —        | —           | —        | 9,318       |
| Total                                   | \$1,161,786        | \$15,482 | \$7,383     | \$—      | \$1,184,651 |

All loans are subject to the assessment of a credit quality indicator. Risk ratings are assigned for each loan at the time of approval, and they change as circumstances dictate during the term of the loan. The Company utilizes a 9-point risk rating scale as shown below, with ratings 1 - 5 included in the Pass column, rating 6 included in the Watch column, ratings 7 - 8 included in the Substandard column and rating 9 included in the Doubtful column. All loans classified as impaired that are included in the specific evaluation of the allowance for loan losses are included in the Substandard column along with all other loans with ratings of 7 - 8.

Risk rating 1: The loan is secured by cash equivalent collateral.

Risk rating 2: The loan is secured by properly margined marketable securities, bonds or cash surrender value of life insurance.

Risk rating 3: The borrower is in strong financial condition and has strong debt service capacity. The loan is performing as agreed, and the financial characteristics and trends of the borrower exceed industry statistics.

Risk rating 4: The borrower is in satisfactory financial condition and has satisfactory debt service capacity. The loan is performing as agreed, and the financial characteristics and trends of the borrower fall in line with industry statistics.

Risk rating 5: The borrower's financial condition is less than satisfactory. The loan is still generally paying as agreed, but strained cash flows may cause some slowness in payments. The collateral values adequately preclude loss on the loan. Financial characteristics and trends lag industry statistics. There may be noncompliance with loan covenants.

Risk rating 6: The borrower's financial condition is deficient. Payment delinquencies may be more common. Collateral values still protect from loss, but margins are narrow. The loan may be reliant on secondary sources of repayment, including liquidation of collateral and guarantor support.

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Risk rating 7: The loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Well-defined weaknesses exist that jeopardize the liquidation of the debt. The Company is inadequately protected by the valuation or paying capacity of the collateral pledged. If deficiencies are not corrected, there is a distinct possibility that a loss will be sustained.

Risk rating 8: All the characteristics of rating 7 exist with the added condition that the loan is past due more than 90 days or there is reason to believe the Company will not receive its principal and interest according to the terms of the loan agreement.

Risk rating 9: All the weaknesses inherent in risk ratings 7 and 8 exist with the added condition that collection or liquidation, on the basis of currently known facts, conditions and values, is highly questionable and improbable. A loan reaching this category would most likely be charged off.

Credit quality indicators for all loans and the Company's risk rating process are dynamic and updated on a continuous basis. Risk ratings are updated as circumstances that could affect the repayment of an individual loan are brought to management's attention through an established monitoring process. Individual lenders initiate changes as appropriate for ratings 1 through 5, and changes for ratings 6 through 9 are initiated via communications with management. The likelihood of loss increases as the risk rating increases and is generally preceded by a loan appearing on the Watch List, which consists of all loans with a risk rating of 6 or worse. Written action plans with firm target dates for resolution of identified problems are maintained and reviewed on a quarterly basis for all segments of criticized loans.

In addition to the Company's internal credit monitoring practices and procedures, an outsourced independent credit review function is in place to further assess assigned internal risk classifications and monitor compliance with internal lending policies and procedures.

In all portfolio segments, the primary risks are that a borrower's income stream diminishes to the point that the borrower is not able to make scheduled principal and interest payments and any collateral securing the loan declines in value. The risk of declining collateral values is present for most types of loans.

Commercial loans consist primarily of loans to businesses for various purposes, including revolving lines to finance current operations, inventory and accounts receivable, and capital expenditure loans to finance equipment and other fixed assets. These loans generally have short maturities, have either adjustable or fixed interest rates, and are either unsecured or secured by inventory, accounts receivable and/or fixed assets. For commercial loans, the primary source of repayment is from the operation of the business.

Real estate loans include various types of loans for which the Company holds real property as collateral, and consist of loans on commercial properties and single and multifamily residences. Real estate loans are typically structured to mature or reprice every five years with payments based on amortization periods up to 30 years. The majority of construction loans are to contractors and developers for construction of commercial buildings or residential real estate. These loans typically have maturities of up to 24 months. The Company's loan policy includes minimum appraisal and other credit guidelines.

Consumer loans include loans extended to individuals for household, family and other personal expenditures not secured by real estate. The majority of the Company's consumer lending is for vehicles, consolidation of personal debts and household improvements. The repayment source for consumer loans, including 1-4 family residential and home equity loans, is typically wages.

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged-off against the allowance for loan losses when management believes that collectability of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb probable losses on existing loans, based on an evaluation of the collectability of loans and prior loss experience. This evaluation also takes into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, the review of specific problem loans, and the current economic conditions that may affect the borrower's ability to pay. While management uses the best information available to make its evaluations, future adjustments to the allowance may be necessary if there are significant changes in economic conditions or the other factors relied upon.

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The allowance for loan losses consists of specific and general components. The specific component relates to loans that meet the definition of impaired. The general component covers the remaining loans and is based on historical loss experience adjusted for qualitative factors such as delinquency trends, loan growth, economic elements and local market conditions. These same policies are applied to all segments of loans. In addition, regulatory agencies, as an integral part of their examination processes, periodically review the Company's allowance for loan losses, and may require the Company to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

The following tables detail the changes in the allowance for loan losses by segment for the three and nine months ended September 30, 2015 and 2014.

## Three Months Ended September 30, 2015

|                          | Real Estate |                       |                        |             |            |                    |          |
|--------------------------|-------------|-----------------------|------------------------|-------------|------------|--------------------|----------|
|                          | Commercial  | Construction and Land | 1-4 Family Residential | Home Equity | Commercial | Consumer and Other | Total    |
| Beginning balance        | \$4,736     | \$1,700               | \$445                  | \$474       | \$6,982    | \$27               | \$14,364 |
| Charge-offs              | (152 )      | —                     | —                      | —           | —          | (2 )               | (154 )   |
| Recoveries               | 201         | —                     | 2                      | 43          | 3          | 1                  | 250      |
| Provision <sup>(1)</sup> | (327 )      | 189                   | (30 )                  | (16 )       | 388        | (4 )               | 200      |
| Ending balance           | \$4,458     | \$1,889               | \$417                  | \$501       | \$7,373    | \$22               | \$14,660 |

## Three Months Ended September 30, 2014

|                          | Real Estate |                       |                        |             |            |                    |          |
|--------------------------|-------------|-----------------------|------------------------|-------------|------------|--------------------|----------|
|                          | Commercial  | Construction and Land | 1-4 Family Residential | Home Equity | Commercial | Consumer and Other | Total    |
| Beginning balance        | \$3,898     | \$2,540               | \$553                  | \$563       | \$5,609    | \$50               | \$13,213 |
| Charge-offs              | —           | —                     | (10 )                  | (60 )       | —          | —                  | (70 )    |
| Recoveries               | 35          | —                     | 2                      | 56          | 7          | 2                  | 102      |
| Provision <sup>(1)</sup> | 347         | (189 )                | 66                     | (18 )       | (107 )     | 1                  | 100      |
| Ending balance           | \$4,280     | \$2,351               | \$611                  | \$541       | \$5,509    | \$53               | \$13,345 |

## Nine Months Ended September 30, 2015

|                          | Real Estate |                       |                        |             |            |                    |          |
|--------------------------|-------------|-----------------------|------------------------|-------------|------------|--------------------|----------|
|                          | Commercial  | Construction and Land | 1-4 Family Residential | Home Equity | Commercial | Consumer and Other | Total    |
| Beginning balance        | \$4,415     | \$2,151               | \$466                  | \$534       | \$6,013    | \$28               | \$13,607 |
| Charge-offs              | (208 )      | —                     | (15 )                  | —           | —          | (2 )               | (225 )   |
| Recoveries               | 528         | 250                   | 4                      | 78          | 9          | 9                  | 878      |
| Provision <sup>(1)</sup> | (277 )      | (512 )                | (38 )                  | (111 )      | 1,351      | (13 )              | 400      |
| Ending balance           | \$4,458     | \$1,889               | \$417                  | \$501       | \$7,373    | \$22               | \$14,660 |

## Nine Months Ended September 30, 2014

| Real Estate |  |  |  |            |  |       |
|-------------|--|--|--|------------|--|-------|
| Commercial  |  |  |  | Commercial |  | Total |

|                          |         | Construction<br>and Land | 1-4 Family<br>Residential | Home<br>Equity |          | Consumer<br>and Other |          |
|--------------------------|---------|--------------------------|---------------------------|----------------|----------|-----------------------|----------|
| Beginning balance        | \$4,199 | \$3,032                  | \$ 613                    | \$403          | \$ 5,485 | \$59                  | \$13,791 |
| Charge-offs              | (577 )  | —                        | (73 )                     | (123 )         | (112 )   | —                     | (885 )   |
| Recoveries               | 87      | 8                        | 4                         | 80             | 7        | 3                     | 189      |
| Provision <sup>(1)</sup> | 571     | (689 )                   | 67                        | 181            | 129      | (9 )                  | 250      |
| Ending balance           | \$4,280 | \$2,351                  | \$ 611                    | \$541          | \$ 5,509 | \$53                  | \$13,345 |

The negative provisions for the various segments are related to either the decline in each of those portfolio (1) segments during the time periods disclosed and/or improvement in the credit quality factors related to those portfolio segments.

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The following tables present a breakdown of the allowance for loan losses disaggregated on the basis of impairment analysis method by segment as of September 30, 2015 and December 31, 2014.

| September 30, 2015                    |            |                                         |                           |                |            |                       |           |
|---------------------------------------|------------|-----------------------------------------|---------------------------|----------------|------------|-----------------------|-----------|
|                                       | Commercial | Real Estate<br>Construction<br>and Land | 1-4 Family<br>Residential | Home<br>Equity | Commercial | Consumer<br>and Other | Total     |
| Ending balance:                       |            |                                         |                           |                |            |                       |           |
| Individually evaluated for impairment | \$ 147     | \$ —                                    | \$ —                      | \$ 274         | \$ 160     | \$ —                  | \$ 581    |
| Collectively evaluated for impairment | 4,311      | 1,889                                   | 417                       | 227            | 7,213      | 22                    | 14,079    |
| Total                                 | \$ 4,458   | \$ 1,889                                | \$ 417                    | \$ 501         | \$ 7,373   | \$ 22                 | \$ 14,660 |

| December 31, 2014                     |            |                                         |                           |                |            |                       |           |
|---------------------------------------|------------|-----------------------------------------|---------------------------|----------------|------------|-----------------------|-----------|
|                                       | Commercial | Real Estate<br>Construction<br>and Land | 1-4 Family<br>Residential | Home<br>Equity | Commercial | Consumer<br>and Other | Total     |
| Ending balance:                       |            |                                         |                           |                |            |                       |           |
| Individually evaluated for impairment | \$ 150     | \$ 200                                  | \$ —                      | \$ 229         | \$ 172     | \$ —                  | \$ 751    |
| Collectively evaluated for impairment | 4,265      | 1,951                                   | 466                       | 305            | 5,841      | 28                    | 12,856    |
| Total                                 | \$ 4,415   | \$ 2,151                                | \$ 466                    | \$ 534         | \$ 6,013   | \$ 28                 | \$ 13,607 |

The following tables present the recorded investment in loans, exclusive of unamortized fees and costs, disaggregated on the basis of impairment analysis method by segment as of September 30, 2015 and December 31, 2014.

| September 30, 2015                    |            |                                         |                           |                |            |                       |              |
|---------------------------------------|------------|-----------------------------------------|---------------------------|----------------|------------|-----------------------|--------------|
|                                       | Commercial | Real Estate<br>Construction<br>and Land | 1-4 Family<br>Residential | Home<br>Equity | Commercial | Consumer<br>and Other | Total        |
| Ending balance:                       |            |                                         |                           |                |            |                       |              |
| Individually evaluated for impairment | \$ 147     | \$ 158                                  | \$ 371                    | \$ 274         | \$ 670     | \$ 4                  | \$ 1,624     |
| Collectively evaluated for impairment | 347,451    | 168,673                                 | 50,785                    | 21,873         | 642,918    | 7,624                 | 1,239,324    |
| Total                                 | \$ 347,598 | \$ 168,831                              | \$ 51,156                 | \$ 22,147      | \$ 643,588 | \$ 7,628              | \$ 1,240,948 |
| December 31, 2014                     |            |                                         |                           |                |            |                       |              |
|                                       | Commercial | Real Estate<br>Construction<br>and Land | 1-4 Family<br>Residential | Home<br>Equity | Commercial | Consumer<br>and Other | Total        |
| Ending balance:                       |            |                                         |                           |                |            |                       |              |
| Individually evaluated for impairment | \$ 456     | \$ 1,201                                | \$ 257                    | \$ 229         | \$ 729     | \$ —                  | \$ 2,872     |
| Collectively evaluated for impairment | 316,452    | 153,289                                 | 53,240                    | 24,271         | 625,209    | 9,318                 | 1,181,779    |

Collectively evaluated for  
impairment

|       |           |           |          |          |           |         |             |
|-------|-----------|-----------|----------|----------|-----------|---------|-------------|
| Total | \$316,908 | \$154,490 | \$53,497 | \$24,500 | \$625,938 | \$9,318 | \$1,184,651 |
|-------|-----------|-----------|----------|----------|-----------|---------|-------------|

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5. Derivatives

The Company uses interest rate swap agreements to assist in its interest rate risk management. The notional amounts of the interest rate swaps do not represent amounts exchanged by the counterparties, but rather, the notional amount is used to determine, along with other terms of the derivative, the amounts to be exchanged between the counterparties.

The Company has variable rate FHLB advances, which create exposure to variability in interest payments due to changes in interest rates. In December 2012, to manage the interest rate risk related to the variability of interest payments, the Company entered into three forward-starting interest rate swap transactions, with a total notional amount of \$80,000. The interest rate swaps effectively convert \$80,000 of variable rate FHLB advances to fixed rate debt as of the forward-starting dates. The three swap transactions were designated as cash flow hedges of the changes in cash flows attributable to changes in LIBOR, the benchmark interest rate being hedged, associated with the interest payments made on the underlying FHLB advances with quarterly interest rate reset dates. One interest rate swap, with a notional amount of \$25,000<sup>(1)</sup>, became effective in December 2014 and was subsequently terminated in March 2015, subject to a termination fee of \$158. A second interest rate swap, with a notional amount of \$25,000<sup>(2)</sup>, was terminated in June 2015, prior to its effective date and subject to a termination fee of \$383. The third interest rate swap, with a notional amount of \$30,000<sup>(3)</sup>, will become effective in December 2015. The termination fees are being reclassified from accumulated other comprehensive income to interest expense over the remaining life of the underlying cash flows, through December 2019 and June 2020, respectively.

In June 2013, the Company entered into a forward-starting interest rate swap transaction with a total notional amount of \$20,000<sup>(4)</sup>, to effectively convert its \$20,000 variable rate junior subordinated notes to fixed rate debt as of the forward-starting date of the swap transaction. The effective date of this swap was June 30, 2014, and it was terminated in September 2014, when the fair value was \$0.

At the inception of each hedge transaction, the Company represented that the underlying principal balance would remain outstanding throughout the hedge transaction, making it probable that sufficient LIBOR-based interest payments would exist through the maturity date of the swaps. The cash flow hedges were determined to be fully effective during the remaining terms of the swaps. Therefore, the aggregate fair value of the remaining swap is recorded in other assets or other liabilities with changes in market value recorded in other comprehensive income, net of deferred taxes. See Note 9 for additional fair value information and disclosures. The amount included in accumulated other comprehensive income for the remaining hedge will be reclassified to interest expense should the hedge no longer be considered effective. No amount of ineffectiveness was included in net income for the nine months ended September 30, 2015 or 2014, and the Company estimates there will be approximately \$542 of cash payments and reclassification from accumulated other comprehensive income (loss) to interest expense through September 30, 2016. The Company will continue to assess the effectiveness of the remaining hedge on a quarterly basis.

The Company is exposed to credit risk in the event of nonperformance by the interest rate swap counterparty. The Company minimizes this risk by entering into derivative contracts with only large, stable financial institutions, and the Company has not experienced, and does not expect, any losses from counterparty nonperformance on the interest rate swaps. The Company monitors counterparty risk in accordance with the provisions of FASB ASC 815. In addition, the interest rate swap agreements contain language outlining collateral-pledging requirements for each counterparty. Collateral must be posted when the market value exceeds certain threshold limits. As of September 30, 2015, the

Company pledged to the counterparty \$990 of required collateral in the form of cash on deposit with a third party.

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The tables below identify the balance sheet category and fair values of the Company's derivative instruments designated as cash flow hedges as of September 30, 2015 and December 31, 2014.

| September 30, 2015 | Swap Number | Notional Amount | Fair Value | Balance Sheet Category | Receive Rate | Pay Rate | Maturity   |
|--------------------|-------------|-----------------|------------|------------------------|--------------|----------|------------|
| Interest rate swap | (3)         | \$30,000        | \$1,116    | Other Liabilities      | 0.66 %       | 2.52 %   | 9/21/2020  |
| December 31, 2014  | Swap Number | Notional Amount | Fair Value | Balance Sheet Category | Receive Rate | Pay Rate | Maturity   |
| Interest rate swap | (1)         | \$25,000        | \$97       | Other Liabilities      | 0.54 %       | 2.10 %   | 12/23/2019 |
| Interest rate swap | (2)         | 25,000          | 87         | Other Liabilities      | 0.56 %       | 2.34 %   | 6/22/2020  |
| Interest rate swap | (3)         | 30,000          | 77         | Other Liabilities      | 0.56 %       | 2.52 %   | 9/21/2020  |

The following tables identify the pre-tax losses recognized on the Company's derivative instruments designated as cash flow hedges for the nine months ended September 30, 2015 and 2014.

| Nine Months Ended September 30, 2015 |             |                                            |                                             |                       |                                     |          |                       |
|--------------------------------------|-------------|--------------------------------------------|---------------------------------------------|-----------------------|-------------------------------------|----------|-----------------------|
|                                      | Swap Number | Effective Portion                          |                                             | Ineffective Portion   |                                     | Category | Amount of Gain (Loss) |
|                                      |             | Amount of Pre-tax (Loss) Recognized in OCI | Reclassified from AOCI into Income Category | Amount of Gain (Loss) | Recognized in Income on Derivatives |          |                       |
| Interest rate swap                   | (1)         | \$(134)                                    | ) Interest Expense                          | \$(93)                | ) Other Income                      |          | \$—                   |
| Interest rate swap                   | (2)         | (297)                                      | ) Interest Expense                          | (25)                  | ) Other Income                      |          | —                     |
| Interest rate swap                   | (3)         | (1,039)                                    | ) Interest Expense                          | —                     | Other Income                        |          | —                     |
| Nine Months Ended September 30, 2014 |             |                                            |                                             |                       |                                     |          |                       |
|                                      | Swap Number | Effective Portion                          |                                             | Ineffective Portion   |                                     | Category | Amount of Gain (Loss) |
|                                      |             | Amount of Pre-tax (Loss) Recognized in OCI | Reclassified from AOCI into Income Category | Amount of Gain (Loss) | Recognized in Income on Derivatives |          |                       |
| Interest rate swap                   | (1)         | \$(545)                                    | ) Interest Expense                          | \$—                   | Other Income                        |          | \$—                   |
| Interest rate swap                   | (2)         | (647)                                      | ) Interest Expense                          | —                     | Other Income                        |          | —                     |
| Interest rate swap                   | (3)         | (843)                                      | ) Interest Expense                          | —                     | Other Income                        |          | —                     |
| Interest rate swap                   | (4)         | (277)                                      | ) Interest Expense                          | (73)                  | ) Other Income                      |          | —                     |



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## 6. Deferred Income Taxes

Net deferred tax assets consisted of the following as of September 30, 2015 and December 31, 2014.

|                                                       | September 30, 2015 | December 31, 2014 |
|-------------------------------------------------------|--------------------|-------------------|
| Deferred tax assets:                                  |                    |                   |
| Allowance for loan losses                             | \$5,571            | \$5,171           |
| Intangibles                                           | 848                | 1,079             |
| Other real estate owned                               | 367                | 367               |
| Accrued expenses                                      | 830                | 891               |
| Restricted stock compensation                         | 230                | 184               |
| Net unrealized losses on interest rate swaps          | 613                | 99                |
| State net operating loss carryforward                 | 1,170              | 1,100             |
| Capital loss carryforward                             | 797                | 797               |
| Other                                                 | 44                 | 46                |
|                                                       | 10,470             | 9,734             |
| Deferred tax liabilities:                             |                    |                   |
| Net deferred loan fees and costs                      | 341                | 334               |
| Premises and equipment                                | 436                | 565               |
| Net unrealized gains on securities available for sale | 684                | 255               |
| Other                                                 | 329                | 350               |
|                                                       | 1,790              | 1,504             |
| Net deferred tax assets before valuation allowance    | 8,680              | 8,230             |
| Valuation allowance                                   | (1,967)            | (1,897)           |
| Net deferred tax assets                               | \$6,713            | \$6,333           |

The Company has recorded a valuation allowance against the tax effect of the state net operating loss carryforwards and federal and state capital loss carryforwards, as management believes it is more likely than not that such carryforwards will expire without being utilized.

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## 7. Accumulated Other Comprehensive Income (Loss)

The following table summarizes the changes in the balances of each component of accumulated other comprehensive income (loss), net of tax, for the nine months ended September 30, 2015 and 2014.

|                                                                  | Noncredit-related                                          |                                                               |                                                   | Accumulated                             |
|------------------------------------------------------------------|------------------------------------------------------------|---------------------------------------------------------------|---------------------------------------------------|-----------------------------------------|
|                                                                  | Unrealized<br>Gains (Losses)<br>on Securities<br>with OTTI | Unrealized<br>Gains (Losses)<br>on Securities<br>without OTTI | Unrealized<br>Gains<br>(Losses) on<br>Derivatives | Other<br>Comprehensive<br>Income (Loss) |
| Balance, December 31, 2013                                       | \$(1,439                                                   | ) \$(4,217                                                    | ) \$2,118                                         | \$(3,538 )                              |
| Other comprehensive income (loss) before reclassifications       | 361                                                        | 4,634                                                         | (1,479                                            | ) 3,516                                 |
| Amounts reclassified from accumulated other comprehensive income | —                                                          | (446                                                          | ) 45                                              | (401 )                                  |
| Net current period other comprehensive income (loss)             | 361                                                        | 4,188                                                         | (1,434                                            | ) 3,115                                 |
| Balance, September 30, 2014                                      | \$(1,078                                                   | ) \$(29                                                       | ) \$684                                           | \$(423 )                                |
| Balance, December 31, 2014                                       | \$—                                                        | \$416                                                         | \$(162                                            | ) \$254                                 |
| Other comprehensive income (loss) before reclassifications       | —                                                          | 747                                                           | (911                                              | ) (164 )                                |
| Amounts reclassified from accumulated other comprehensive income | —                                                          | (47                                                           | ) 73                                              | 26                                      |
| Net current period other comprehensive income (loss)             | —                                                          | 700                                                           | (838                                              | ) (138 )                                |
| Balance, September 30, 2015                                      | \$—                                                        | \$1,116                                                       | \$(1,000                                          | ) \$116                                 |

## 8. Commitments and Contingencies

Financial instruments with off-balance-sheet risk: The Company is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations that it uses for on-balance-sheet instruments. The Company's commitments consisted of the following approximate amounts as of September 30, 2015 and December 31, 2014.

|                              | September 30, 2015 | December 31, 2014 |
|------------------------------|--------------------|-------------------|
| Commitments to extend credit | \$526,573          | \$441,124         |
| Standby letters of credit    | 5,803              | 14,595            |
|                              | \$532,376          | \$455,719         |

West Bank previously had executed Mortgage Partnership Finance (MPF) Master Commitments (Commitments) with the FHLB of Des Moines to deliver mortgage loans and to guarantee the payment of any realized losses that exceed

the FHLB's first loss account for mortgages delivered under the Commitments. West Bank receives credit enhancement fees from the FHLB for providing this guarantee and continuing to assist with managing the credit risk of the MPF Program mortgage loans. The term of the most recent Commitment was through January 16, 2015 and was not renewed. At September 30, 2015, the liability represented by the present value of the credit enhancement fees less any expected losses in the mortgages delivered under the Commitments was approximately \$377.

Contractual commitments: The Company has remaining commitments to invest in four qualified affordable housing projects totaling \$4,292 as of September 30, 2015.

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Contingencies: On September 29, 2010, West Bank was sued in a class action lawsuit that, as amended, asserts nonsufficient funds fees charged by West Bank to Iowa resident customers on debit card transactions are usurious under the Iowa Consumer Credit Code, rather than allowable fees, and that the sequence in which West Bank formerly posted debit card transactions for payment violated various alleged duties of good faith and ordinary care. Plaintiffs are seeking alternative remedies that include injunctive relief, damages (including treble damages), punitive damages, refund of fees and attorney fees. The case is currently being brought by Darla and Jason T. Legg, on behalf of themselves and all others similarly situated, in the Iowa District Court for Polk County, Iowa. West Bank believes it has substantial defenses and is vigorously defending the action. The trial court entered orders on preliminary motions on March 4, 2014. It dismissed one of the plaintiffs' claims and found that factual disputes precluded summary judgment in West Bank's favor on the remaining claims. In addition, the court certified two classes for further proceedings. West Bank appealed the adverse rulings to the Iowa Supreme Court. The Iowa Supreme Court heard oral arguments on October 13, 2015. The cases have now been submitted for decisions, and West Bank believes the opinions will be released during the first half of 2016. The amount of potential loss, if any, cannot be reasonably estimated now because of the unresolved legal issues and because, among other things, the multiple alternative claims involve different time periods, burdens of proof, defenses and potential remedies.

Except as described above, neither the Company nor West Bank is a party, and no property of these entities is subject, to any other material pending legal proceedings, other than ordinary routine litigation incidental to West Bank's business. The Company does not know of any proceeding contemplated by a governmental authority against the Company or West Bank.

## 9. Fair Value Measurements

Accounting guidance on fair value measurements and disclosures defines fair value and establishes a framework for measuring the fair value of assets and liabilities using a hierarchy system. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts business.

The Company's balance sheet contains securities available for sale and derivative instruments that are recorded at fair value on a recurring basis. The three-level valuation hierarchy for disclosure of fair value is as follows:

Level 1 uses quoted market prices in active markets for identical assets or liabilities.

Level 2 uses observable market-based inputs or unobservable inputs that are corroborated by market data.

Level 3 uses unobservable inputs that are not corroborated by market data.

The Company's policy is to recognize transfers between Levels at the end of each reporting period, if applicable. There were no transfers between Levels of the fair value hierarchy during the nine months ended September 30, 2015.

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value on a recurring basis.

Investment securities available for sale: When available, quoted market prices are used to determine the fair value of investment securities. If quoted market prices are not available, the Company determines fair value based on various sources and may apply matrix pricing with observable prices for similar bonds where a price for the identical bond is not observable. The fair values of these securities are determined by pricing models that consider observable market data such as interest rate volatilities, LIBOR yield curve, credit spreads, prices from market makers and live trading systems. Level 1 securities include certain corporate bonds and preferred stocks, and would include U.S. Treasuries, if any were held. Level 2 securities include U.S. government and agency securities, collateralized mortgage obligations, mortgage-backed securities, state and political subdivision securities, and a trust preferred security. The Company currently holds no investment securities classified as Level 3.

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Generally, management obtains the fair value of investment securities at the end of each reporting period via a third party pricing service. Management, with the assistance of an independent investment advisory firm, reviewed the valuation process used by the third party and believes that process was valid. On a quarterly basis, management corroborates the fair values of investment securities by obtaining pricing from an independent investment advisory firm and compares the two sets of fair values. Any significant variances are reviewed and investigated. In addition, the Company has instituted a practice of further testing the fair values of a sample of securities. For that sample, the prices are further validated by management, with assistance from an independent investment advisory firm, by obtaining details of the inputs used by the pricing service. Those inputs were independently tested, and management concluded the fair values were consistent with GAAP requirements and securities were properly classified in the fair value hierarchy.

Derivative instruments: The Company's derivative instruments consist of interest rate swaps, which are accounted for as cash flow hedges. The Company's derivative position is classified within Level 2 of the fair value hierarchy and is valued using models generally accepted in the financial services industry and that use actively quoted or observable market input values from external market data providers and/or non-binding broker-dealer quotations. The fair value of the derivatives are determined using discounted cash flow models. These models' key assumptions include the contractual terms of the respective contract along with significant observable inputs, including interest rates, yield curves, nonperformance risk and volatility.

The following tables present the balances of assets and liabilities measured at fair value on a recurring basis by level as of September 30, 2015 and December 31, 2014.

|                                             | September 30, 2015 |         |          |         |
|---------------------------------------------|--------------------|---------|----------|---------|
|                                             | Total              | Level 1 | Level 2  | Level 3 |
| Financial assets:                           |                    |         |          |         |
| Investment securities available for sale:   |                    |         |          |         |
| U.S. government agencies and corporations   | \$2,729            | \$—     | \$2,729  | \$—     |
| State and political subdivisions            | 62,540             | —       | 62,540   | —       |
| Collateralized mortgage obligations         | 142,206            | —       | 142,206  | —       |
| Mortgage-backed securities                  | 106,949            | —       | 106,949  | —       |
| Trust preferred security                    | 1,036              | —       | 1,036    | —       |
| Corporate notes and equity securities       | 10,157             | 9,857   | 300      | —       |
| Financial liabilities:                      |                    |         |          |         |
| Derivative instruments, interest rate swaps | \$1,116            | \$—     | \$1,116  | \$—     |
|                                             | December 31, 2014  |         |          |         |
|                                             | Total              | Level 1 | Level 2  | Level 3 |
| Financial assets:                           |                    |         |          |         |
| Investment securities available for sale:   |                    |         |          |         |
| U.S. government agencies and corporations   | \$12,820           | \$—     | \$12,820 | \$—     |
| State and political subdivisions            | 52,359             | —       | 52,359   | —       |
| Collateralized mortgage obligations         | 125,870            | —       | 125,870  | —       |
| Mortgage-backed securities                  | 66,153             | —       | 66,153   | —       |
| Trust preferred security                    | 918                | —       | 918      | —       |

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|                                             |        |        |       |     |
|---------------------------------------------|--------|--------|-------|-----|
| Corporate notes and equity securities       | 14,670 | 14,370 | 300   | —   |
| Financial liabilities:                      |        |        |       |     |
| Derivative instruments, interest rate swaps | \$261  | \$—    | \$261 | \$— |

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The following table presents changes in investment securities available for sale with significant unobservable inputs (Level 3) for the three and nine months ended September 30, 2015 and 2014. The activity in the table consists of one pooled trust preferred security, which was considered to have OTTI and was sold in December 2014.

|                                        | Three Months Ended September 30, |         | Nine Months Ended September 30, |         |
|----------------------------------------|----------------------------------|---------|---------------------------------|---------|
|                                        | 2015                             | 2014    | 2015                            | 2014    |
| Beginning balance                      | \$—                              | \$2,207 | \$—                             | \$1,850 |
| Transfer into level 3                  | —                                | —       | —                               | —       |
| Total gains:                           |                                  |         |                                 |         |
| Included in earnings                   | —                                | —       | —                               | —       |
| Included in other comprehensive income | —                                | 226     | —                               | 583     |
| Sale of security                       | —                                | —       | —                               | —       |
| Principal payments                     | —                                | —       | —                               | —       |
| Ending balance                         | \$—                              | \$2,433 | \$—                             | \$2,433 |

Certain assets are measured at fair value on a nonrecurring basis. That is, they are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following tables present those assets carried on the balance sheet by caption and by level within the valuation hierarchy as of September 30, 2015 and December 31, 2014.

|                         | September 30, 2015 |         |         |         |
|-------------------------|--------------------|---------|---------|---------|
|                         | Total              | Level 1 | Level 2 | Level 3 |
| Impaired loans          | \$158              | \$—     | \$—     | \$158   |
| Other real estate owned | 2,235              | —       | —       | 2,235   |

|                         | December 31, 2014 |         |         |         |
|-------------------------|-------------------|---------|---------|---------|
|                         | Total             | Level 1 | Level 2 | Level 3 |
| Impaired loans          | \$1,266           | \$—     | \$—     | \$1,266 |
| Other real estate owned | 2,235             | —       | —       | 2,235   |

Loans in the previous tables consist of impaired loans for which a fair value adjustment was recorded. Impaired loans are evaluated and valued at the lower of cost or fair value when the loan is identified as impaired. Fair value is measured based on the value of the collateral securing these loans. Collateral may be real estate or business assets such as equipment, inventory or accounts receivable. Fair value is determined by management evaluations or independent appraisals. Appraised or reported values may be discounted based on management's opinions concerning market developments or the client's business. Other real estate owned in the tables above consists of property acquired through foreclosures and loan settlements. Property acquired is carried at fair value of the property less estimated disposal costs. Fair value of other real estate owned is determined by management by obtaining appraisals or other market value information at the time of acquisition, is updated at least annually, and may be discounted.

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The following tables present additional quantitative information about assets measured at fair value on a nonrecurring basis for which the Company has utilized Level 3 inputs to determine fair value as of September 30, 2015 and December 31, 2014.

| September 30, 2015      |            |                          |                      |                      |
|-------------------------|------------|--------------------------|----------------------|----------------------|
|                         | Fair Value | Valuation Technique      | Unobservable Input   | Range (Average)      |
| Impaired loans          | \$158      | Evaluation of collateral | Estimation of value  | NM*                  |
| Other real estate owned | 2,235      | Appraisal                | Appraisal adjustment | 0.0% - 25.0% (25.0%) |
| December 31, 2014       |            |                          |                      |                      |
|                         | Fair Value | Valuation Technique      | Unobservable Input   | Range (Average)      |
| Impaired loans          | \$1,266    | Evaluation of collateral | Estimation of value  | NM*                  |
| Other real estate owned | 2,235      | Appraisal                | Appraisal adjustment | 0.0% - 25.0% (25.0%) |

\* Not Meaningful. Evaluations of the underlying assets are completed for each impaired loan with a specific reserve. The types of collateral vary widely and could include accounts receivables, inventory, a variety of equipment and real estate. Collateral evaluations are reviewed and discounted as appropriate based on knowledge of the specific type of collateral. In the case of real estate, an independent appraisal may be obtained. Types of discounts considered included aging of receivables, condition of the collateral, potential market for the collateral and estimated disposal costs. These discounts will vary from loan to loan, thus providing a range would not be meaningful.

GAAP requires disclosure of the fair value of financial assets and financial liabilities, including those that are not measured and reported at fair value on a recurring or nonrecurring basis. The methodologies for estimating the fair value of financial assets and financial liabilities that are measured at fair value on a recurring or nonrecurring basis are discussed above. The methodologies for other financial assets and financial liabilities are discussed below.

Cash and due from banks: The carrying amount approximates fair value.

Federal funds sold: The carrying amount approximates fair value.

Investment securities held to maturity: The fair values of these securities, which are all state and political subdivisions, are determined by the same method described previously for investment securities available for sale.

FHLB stock: The fair value of this restricted stock is estimated at its carrying value and redemption price of \$100 per share.

Loans: The fair values of fixed rate loans are estimated using discounted cash flow analysis based on observable market interest rates currently being offered for loans with similar terms to borrowers with similar credit quality. The carrying values of variable rate loans approximate their fair values.

Deposits: The carrying amounts for demand and savings deposits, which represent the amounts payable on demand, approximate their fair values. The fair values for certificates of deposit are estimated using discounted cash flow analysis, based on observable market interest rates currently being offered on certificates with similar terms.

Accrued interest receivable and payable: The fair values of both accrued interest receivable and payable approximate their carrying amounts.

Borrowings: The carrying amounts of federal funds purchased, short-term borrowings, variable rate FHLB advances, and variable rate long-term borrowings approximate their fair values. Fair values of subordinated notes, fixed rate FHLB advances and other long-term borrowings are estimated using discounted cash flow analysis, based on observable market interest rates currently being offered with similar terms.

Commitments to extend credit and standby letters of credit: The approximate fair values of commitments and standby letters of credit are based on the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and creditworthiness of the counterparties.

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The following table presents the carrying amounts and approximate fair values of financial assets and liabilities as of September 30, 2015 and December 31, 2014.

|                                          |                            | September 30, 2015 |                        | December 31, 2014 |                        |
|------------------------------------------|----------------------------|--------------------|------------------------|-------------------|------------------------|
|                                          | Fair Value Hierarchy Level | Carrying Amount    | Approximate Fair Value | Carrying Amount   | Approximate Fair Value |
| Financial assets:                        |                            |                    |                        |                   |                        |
| Cash and due from banks                  | Level 1                    | \$36,194           | \$36,194               | \$27,936          | \$27,936               |
| Federal funds sold                       | Level 1                    | 18,592             | 18,592                 | 11,845            | 11,845                 |
| Investment securities available for sale | See previous table         | 325,617            | 325,617                | 272,790           | 272,790                |
| Investment securities held to maturity   | Level 2                    | 51,280             | 51,260                 | 51,343            | 51,501                 |
| Federal Home Loan Bank stock             | Level 1                    | 14,210             | 14,210                 | 15,075            | 15,075                 |
| Loans, net <sup>(1)</sup>                | Level 2                    | 1,225,378          | 1,232,652              | 1,170,438         | 1,199,832              |
| Accrued interest receivable              | Level 1                    | 5,041              | 5,041                  | 4,425             | 4,425                  |
| Financial liabilities:                   |                            |                    |                        |                   |                        |
| Deposits                                 | Level 2                    | 1,387,136          | 1,387,459              | 1,270,462         | 1,270,987              |
| Federal funds purchased                  | Level 1                    | 2,660              | 2,660                  | 2,975             | 2,975                  |
| Short-term borrowings                    | Level 1                    | 59,000             | 59,000                 | 66,000            | 66,000                 |
| Subordinated notes                       | Level 2                    | 20,619             | 11,909                 | 20,619            | 13,330                 |
| Federal Home Loan Bank advances, net     | Level 2                    | 98,008             | 98,639                 | 96,888            | 96,312                 |
| Long-term debt                           | Level 2                    | 9,730              | 9,641                  | 12,676            | 12,571                 |
| Accrued interest payable                 | Level 1                    | 389                | 389                    | 419               | 419                    |
| Interest rate swaps                      | Level 2                    | 1,116              | 1,116                  | 261               | 261                    |
| Off-balance-sheet financial instruments: |                            |                    |                        |                   |                        |
| Commitments to extend credit             | Level 3                    | —                  | —                      | —                 | —                      |
| Standby letters of credit                | Level 3                    | —                  | —                      | —                 | —                      |

(1) All loans are Level 2 except impaired loans of \$158 and \$1,266 as of September 30, 2015 and December 31, 2014, respectively, which are Level 3.

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West Bancorporation, Inc.

Management's Discussion and Analysis

(in thousands, except share and per share data)

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

"SAFE HARBOR" CONCERNING FORWARD-LOOKING STATEMENTS

Certain statements in this report, other than purely historical information, including estimates, projections, statements relating to our business plans, objectives and expected operating results, and the assumptions upon which those statements are based, are "forward-looking statements" within the meanings of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). Forward-looking statements may appear throughout this report. These forward-looking statements are generally identified by the words "believes," "expects," "intends," "anticipates," "projects," "future," "may," "should," "will," "strategy," "plan," "opportunity," "will be," "will likely result," "will continue" or similar references to estimates, predictions or future events. Such forward-looking statements are based upon certain underlying assumptions, risks and uncertainties. Because of the possibility that the underlying assumptions are incorrect or do not materialize as expected in the future, actual results could differ materially from these forward-looking statements. Risks and uncertainties that may affect future results include: interest rate risk; competitive pressures; pricing pressures on loans and deposits; changes in credit and other risks posed by the Company's loan and investment portfolios, including declines in commercial or residential real estate values or changes in the allowance for loan losses dictated by new market conditions or regulatory requirements; actions of bank and nonbank competitors; changes in local and national economic conditions; changes in regulatory requirements, limitations and costs; changes in customers' acceptance of the Company's products and services; cyber-attacks; and any other risks described in the "Risk Factors" sections of this and other reports filed by the Company with the Securities and Exchange Commission. The Company undertakes no obligation to revise or update such forward-looking statements to reflect current or future events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

CRITICAL ACCOUNTING POLICIES

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements that have been prepared in accordance with GAAP. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, income and expenses. These estimates are based upon historical experience and on various other assumptions that management believes are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The estimates and judgments that management believes have the most effect on the Company's reported financial position and results of operations are described as critical accounting policies in the Company's Annual Report on Form 10-K for the year ended December 31, 2014, as filed with the Securities and Exchange Commission on March 5, 2015. There have been no significant changes in the critical accounting policies or the assumptions and judgments utilized in applying these policies since the year ended December 31, 2014.

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West Bancorporation, Inc.

Management's Discussion and Analysis

(in thousands, except share and per share data)

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2015

OVERVIEW

The following discussion describes the consolidated operations and financial condition of the Company, which includes West Bank and West Bank's wholly owned subsidiary WB Funding Corporation (which owns an interest in SmartyPig, LLC). West Bank's 99.99 percent owned subsidiary ICD IV, LLC, a community development entity, was liquidated during the third quarter of 2014 when the underlying loan matured. Results of operations for the three and nine months ended September 30, 2015 are compared to the results for the same periods in 2014, and the consolidated financial condition of the Company as of September 30, 2015 is compared to balances as of December 31, 2014. The Company operates in three markets: central Iowa, which is generally the greater Des Moines metropolitan area; eastern Iowa, which is the area including and surrounding Iowa City and Coralville, Iowa; and the Rochester, Minnesota area.

Net income for the three months ended September 30, 2015 was \$5,426, or \$0.34 per diluted common share, compared to \$5,063, or \$0.32 per diluted common share, for the three months ended September 30, 2014. The Company's annualized return on average assets (ROA) and return on average equity (ROE) for the three months ended September 30, 2015 were 1.28 and 14.63 percent, respectively, compared to 1.32 and 15.00 percent, respectively, for the three months ended September 30, 2014.

The increase in net income for the three months ended September 30, 2015 compared to the same period in 2014 was primarily due to a \$1,417 increase in net interest income. The 11.5 percent increase in net interest income over the same three months of 2014 was primarily the result of loan growth. The increase in net interest income was partially offset by an increase of \$100 in the provision for loan losses, a \$412 reduction in revenue from residential mortgage banking, a reduction of \$210 in investment securities gains, and a \$163 increase in noninterest expense. As previously disclosed, the Company changed its process for providing first mortgage loans to its customers at the end of 2014. Starting in January 2015, residential mortgage underwriting and processing were outsourced, and funding for residential mortgages is provided by a third party. The Company now receives a fee from that third party for each residential mortgage loan initiated and closed by our retail staff. The reduction in this source of revenue had a correlating reduction in associated operating costs.

Net income for the nine months ended September 30, 2015 was \$15,801, or \$0.98 per diluted common share, compared to \$14,202, or \$0.89 per diluted common share, for the nine months ended September 30, 2014. The Company's annualized ROA and ROE for the nine months ended September 30, 2015 were 1.28 and 14.62 percent, respectively, compared to 1.27 and 14.61 percent, respectively, for the nine months ended September 30, 2014.

The improvement in net income for first nine months of 2015 compared to the same period in 2014 was primarily due to a \$3,810, or 10.5 percent, increase in net interest income for the same reason mentioned above. Partially offsetting this increase for the first nine months of 2015 compared to the same period in 2014, the provision for loan losses increased \$150, and noninterest income declined \$1,776, mainly due to lower residential mortgage banking revenue and lower net gains on sales of investment securities. Noninterest expense declined \$314 for the first nine months of 2015 compared to the first nine months of 2014 primarily due to the combination of the change in residential mortgage banking operations and lower costs associated with holding other real estate owned.

Total loans outstanding increased \$55,993 during the first nine months of the year compared to December 31, 2014. Management believes loan growth will continue to be strong in the fourth quarter of 2015, but may be somewhat

mitigated by expected payoffs. Credit quality remained strong as evidenced by the Company's Texas ratio, which was 2.35 percent as of September 30, 2015 compared to 2.71 percent as of December 31, 2014. As of September 30, 2015, the allowance for loan losses was 1.18 percent of loans outstanding compared to 1.15 percent as of December 31, 2014.

The Company was recently named as a "Sm-All Star" for the fourth year in a row by the investment banking firm Sandler O'Neill + Partners, L.P. The list is composed of top-performing, publicly traded, small-cap banks and thrifts in the United States. For purposes of the analysis, small-cap companies were those with a market value between \$25 million and \$2.5 billion. Out of 435 comparable companies, only 34 were named as 2015 Sm-All Stars. The Company is the only bank or thrift on the list in 2015 to receive the honor for the fourth consecutive year and is the only Iowa or Minnesota bank to be recognized. The criteria used to determine the 2015 Sm-All Stars concentrated on growth, profitability, credit quality and capital strength. Additional criteria included having a net charge-off ratio over the prior 12 months of less than 0.25 percent and a tangible common equity ratio above 7.00 percent as of June 30, 2015.

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West Bancorporation, Inc.

Management's Discussion and Analysis

(in thousands, except share and per share data)

The Company's four key performance metrics are compared to our identified peer group of 16 companies throughout the year. The group of 16 publicly traded peer financial institutions against which we compared our performance each quarter consists of BankFinancial Corporation, Baylake Corp., Farmers Capital Bank Corporation, First Defiance Financial Corp., First Mid-Illinois Bancshares, Inc., Hills Bancorporation, Horizon Bancorp, Isabella Bank Corporation, Mercantile Bank Corporation, MidWestOne Financial Group, Inc., MutualFirst Financial, Inc., Peoples Bancorp, Pulaski Financial Corp., QCR Holdings, Inc., Southwest Bancorp and Waterstone Financial, Inc. When contrasted with the peer group's metrics through June 30, 2015, the Company's metrics for the nine months ended September 30, 2015 were better than those of each company in the peer group as of June 30, 2015 (latest data available) as shown in the table below.

|                          | West<br>Bancorporation,<br>Inc.<br>Nine months<br>ended September<br>30, 2015 | Peer Group Range<br>Six months ended<br>June 30, 2015 |
|--------------------------|-------------------------------------------------------------------------------|-------------------------------------------------------|
| Return on average assets | 1.28%                                                                         | 0.28% - 1.26%                                         |
| Return on average equity | 14.62%                                                                        | 2.17% - 12.49%                                        |
| Efficiency ratio*        | 47.12%                                                                        | 53.49% - 78.29%                                       |
| Texas ratio*             | 2.35%                                                                         | 2.97% - 33.63%                                        |

\* A lower ratio is more desirable.

The Company's previously disclosed plan to build a permanent office in Rochester, Minnesota moved forward with a formal ground breaking on October 5, 2015. The new facility is expected to open in the third quarter of 2016, and we believe it will enhance our ability to expand our customer base in that market.

The Board of Directors declared a quarterly dividend of \$0.16 per common share at its meeting on October 28, 2015. The dividend is payable on November 25, 2015, to stockholders of record as of November 11, 2015.

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West Bancorporation, Inc.

Management's Discussion and Analysis

(in thousands, except share and per share data)

## RESULTS OF OPERATIONS

The following table shows selected financial results and measures for the three and nine months ended September 30, 2015 compared with the same periods in 2014.

|                                        | Three Months Ended September 30, |   |           |   |         |          | Nine Months Ended September 30, |   |           |   |         |          |
|----------------------------------------|----------------------------------|---|-----------|---|---------|----------|---------------------------------|---|-----------|---|---------|----------|
|                                        | 2015                             |   | 2014      |   | Change  | Change % | 2015                            |   | 2014      |   | Change  | Change % |
| Net income                             | \$5,426                          |   | \$5,063   |   | \$363   | 7.17 %   | \$15,801                        |   | \$14,202  |   | \$1,599 | 11.26 %  |
| Average assets                         | 1,678,005                        |   | 1,517,145 |   | 160,860 | 10.60 %  | 1,652,232                       |   | 1,493,024 |   | 159,208 | 10.66 %  |
| Average stockholders' equity           | 147,120                          |   | 133,896   |   | 13,224  | 9.88 %   | 144,540                         |   | 129,958   |   | 14,582  | 11.22 %  |
| Return on average assets               | 1.28                             | % | 1.32      | % | (0.04)  | )%       | 1.28                            | % | 1.27      | % | 0.01    | %        |
| Return on average equity               | 14.63                            | % | 15.00     | % | (0.37)  | )%       | 14.62                           | % | 14.61     | % | 0.01    | %        |
| Net interest margin                    | 3.59                             | % | 3.56      | % | 0.03    | %        | 3.59                            | % | 3.58      | % | 0.01    | %        |
| Efficiency ratio*                      | 46.30                            | % | 48.39     | % | (2.09)  | )%       | 47.12                           | % | 50.16     | % | (3.04)  | )%       |
| Dividend payout ratio                  | 47.36                            | % | 37.96     | % | 9.40    | %        | 46.72                           | % | 39.43     | % | 7.29    | %        |
| Average equity to average assets ratio | 8.77                             | % | 8.83      | % | (0.06)  | )%       | 8.75                            | % | 8.70      | % | 0.05    | %        |
|                                        |                                  |   |           |   |         |          | As of September 30,             |   |           |   |         |          |
|                                        |                                  |   |           |   |         |          | 2015                            |   | 2014      |   | Change  |          |
| Texas ratio*                           |                                  |   |           |   |         |          | 2.35                            | % | 6.21      | % | (3.86)  | )%       |
| Equity to assets ratio                 |                                  |   |           |   |         |          |                                 |   |           |   |         |          |