



TEXAS SECURITY

BANK



ELEVATING THE CHAMPIONS OF FREE  
ENTERPRISE

2018 ANNUAL REPORT  
TEXAS SECURITY BANKSHARES, INC.

For some – reaching the peak is not enough. There is always the drive to achieve more. To soar to new levels.

This is the attitude that propels the Champions of Free Enterprise – those individuals who start and grow their own businesses through hard work, strong values and savvy financial strategies. At Texas Security Bank, we have dedicated ourselves to elevating business owners for more than a decade. This annual report is for you, our business customers and investors, for whom we continually aim to accomplish more. You motivate us to aspire to a higher level of achievement. Uplifting you and your endeavors makes success all the more satisfying.

ASPIRING  
HIGHER



*“As a small business owner, they help me **LEARN.**”*

**Carlyn Ray**  
President, Carlyn Ray Designs



*“You don’t realize what having a bank who’s a **TEAM MEMBER** can be – until you have one.”*

**Ed Christmas**  
Founder, Managing Principal, Sology Solutions



*“TSB is like having a partner to help **SOLVE YOUR ISSUES** and recommend the best fit.”*

**Cory A. Roberts, M.D.**  
President, Chairman, Chief Executive Officer, ProPath



*“Here, you work with entrepreneurs who are putting their own **SKIN IN THE GAME.**”*

**Michael Schneider**  
Chief Executive Officer, A1 Locksmith



*“What does TSB bring to me? They trust me and I **TRUST** them.”*

**Carla Luig**  
President, Chief Executive Officer, First Choice Transport

## Dear fellow shareholders,



For Texas Security Bankshares, Inc. (TSB), the year 2018 was eventful. Not all developments were welcome, but overall it left us confident in the strength of our organization and positive about the year to come.

Net income was up slightly over 2017. Our net interest margin was up \$2.4 million, or 17%, to \$16.9 million, due to a 17% loan growth of over \$55 million for the year. Service charges on deposit accounts increased 27%, and total deposits increased \$60 million, which represents 17% growth as well. Your bank continues to grow.

Non-interest expense increased 10% in 2018 to just under \$10 million, due to strategic initiatives to enhance TSB's infrastructure in sales management, compliance, credit administration, accounting and financial planning resources. These systems will enable better decision-making throughout TSB and will position us to manage growth profitably.

Pre-tax, pre-provision earnings were up 21% to \$8.9 million. On the other hand, our provision for loan losses was extraordinarily high at \$4.0 million, driving down our pre-tax earnings to \$4.9 million. The provision for loan losses was \$3.5 million greater than it would have been due to the first charge-off of significance in TSB's history. The loan, originated in 2015 in participation with a large bank group, was made to a borrower operating in a healthcare niche that began experiencing much greater competition. On the upside, this was a unique loan for us and not representative of our typical lending, so we believe the outcome was an anomaly.

Our reduced net income resulted in a 0.8% return on assets and 7.8% return on equity. Without the effects of the charge-off, these returns would have been 1.4% and 12.8%, respectively. Over the 10+ years of TSB's operating history, including 2018, total charge-offs have amounted to less than 0.2%, or \$4.3 million. That alone is admirable.

Looking ahead, our excellent credit quality puts us in good standing. Non-performing loans total \$92 thousand, or 0.02% of the portfolio, compared to our peer group average of 0.62%.

During 2018, TSB's outstanding shares of stock (net of treasury stock) increased by 181,206 to 3,216,874 shares, another indicator of a positive outlook for TSB. Moreover, TSB has achieved continued strong asset growth of 16% and core earnings growth of 21%. For these reasons, we are excited about 2019. Above all, we will continue to Elevate the Champions of Free Enterprise, while we explore every opportunity to increase shareholder wealth.

**Craig Scheef**  
Chairman, President  
Chief Executive Officer

**Drew Keith**  
Executive Vice President  
Chief Financial Officer  
Chief Operating Officer

**Chris Jones**  
Executive Vice President  
Chief Lending Officer

## Meet our leadership

### Leadership Team

(first row, left to right)

**Craig Scheef**  
Chairman, President, Chief Executive Officer

**Chris Jones**  
Executive Vice President, Chief Lending Officer

**Drew Keith**  
Executive Vice President, Chief Financial Officer

(second row, left to right)

**Shon Cass**  
Senior Vice President, Integrated Sales & Service

**Libby Smith**  
Senior Vice President, Mortgage Lending

**Chris Benson**  
Senior Vice President, Senior Credit Officer

(third row, left to right)

**Casey Herr**  
Senior Vice President, Garland Market President

**Ben Parkey**  
Senior Vice President, Turtle Creek Market President

**C.D. Heinen**  
Senior Vice President, Metrocrest Market President



### Board of Directors

(left to right)

**Scott Miller**  
Principal, Miller Global Investments, LLC

**Larry Waisanen**  
Retired, EVP/CFO, Lafarge North America, Inc.

**Chris Jones**  
Texas Security Bank

**LeAnn Nabors**  
CFO, The Wright Group

**Gina Norris**  
SVP Partner Relations, Matthews Southwest

**Langhorne Reid**  
President, Arcady Capital, Inc.

**Drew Keith**  
Texas Security Bank

**Kip Kernodle**  
Retired, CFO & Director, Allflex Holdings, Inc.

**Craig Scheef**  
Texas Security Bank

**Cortney Liddiard**  
CEO, Ball Ventures, LLC (not pictured)

**Mike Thomas**  
President, Life Sciences and Healthcare Technologies (not pictured)



## LIVING OUR VALUES

You would expect a thriving organization like TSB to espouse a set of values, and we do. But our values do not just live on a document. They are integral to how we operate. We live them daily.

We begin every internal executive meeting by focusing on a particular value and discussing how we can apply it to our decision-making. Individually, we each strive to internalize these values, and this creates the values-driven culture that defines our Bank.

We do more than offer services to customers; we solve problems. We go beyond paying tribute to integrity; we walk the talk. We believe that taking our values to heart separates us from many other financial institutions.

There is something about how we do business that says, "We don't let good enough be good enough." This is the philosophy that continues inspiring trust in our business partners.

**Integrity and Honesty**

**Growth**

**Team Players**

**Independent Thinking**

**Exemplary Customer Service**

**Winning**

**Problem Solving**

**Creativity**

**Discipline to Process**

**Diligence**



# SOLVING PROBLEMS

## Growing businesses with SBA loans

Small Business Administration (SBA) loans are especially advantageous to businesses that otherwise would find it difficult to qualify for bank loans. SBA loans can help businesses when a collateral shortfall, undercapitalization or insufficient earnings history impede their ability to qualify for typical commercial loans. Our status as an SBA Preferred Lender allows us to serve more owner-managed businesses. In addition, we can authorize lower down payments and more extended terms for certain loan types. Businesses can borrow for working capital, lines of credit, equipment, real estate, construction and more. We are proud to offer small businesses the tools to aspire to higher goals.

## TSB Speaker Series

Businesses that are effective at problem solving are those that continuously learn from experts. That is why we created the TSB Speaker Series. In 2018, our presentations and complimentary lunches included a visit by U.S. Congressman Pete Sessions for an exclusive discussion of how issues in Washington D.C. affect your business. We also focused on such important topics as 2018 tax reform changes, mitigating cyber security risks, initiatives for better budgeting, the power of open book management and more. In addition to providing business owners with more knowledge, the TSB Speaker Series offers an environment of support where owners can meet and share valuable insights.

## TSB Academy

How do owner-operated business leaders take their businesses to the next level without interrupting existing business management? They attend TSB Academy. For CEOs or primary business executives, the Academy's Executive Business Curriculum is designed to leverage your existing experience and provide the additional depth of knowledge to grow your business. The Academy offers 50 hours of instruction on essential foundational, leadership, sales and management skills needed to elevate your business. Sessions are twice per month for three trimesters. The first TSB Academy class began in July 2018 and graduates in June 2019. The second class started in January 2019 and graduates in November. For more information or to apply, visit us at [TexasSecurityBank.com](http://TexasSecurityBank.com).



**Kyleene Rundus**  
Co-Executive Director  
TSB Academy

**Karen Bennett**  
Co-Executive Director  
TSB Academy

*"We were excited to carry out CEO Craig Scheef's vision for TSB Academy. It's an invaluable opportunity for small business owners to learn more about the essential foundational, leadership, sales and management skills needed to elevate their businesses."*

Kyleene Rundus

*"Through the TSB Academy, I have gained so much knowledge, new tools and resources to better myself, my staff and the business. Texas Security Bank is going above and beyond to ensure their customers' success and knowledge. Thank you TSB!"*

**Pam Cordell, CFO**  
Wallace Electronics  
TSB Academy Participant

*"TSB backs up their commitment to the success of free market enterprise with their own time and treasure."*

**Mark Davis Bailey, President and CEO**  
The Original Pancake House - DFW  
TSB Academy Participant



## Your success is one of our greatest aspirations

Entrepreneurs who start their own businesses are natural problem solvers. You couldn't own and operate a business without that ability. But in addition to solving problems, you also never stop learning how to improve. From the beginning, our vision at TSB has been to serve entrepreneurs. This is why we became an SBA Preferred Lender, which allows us to help small businesses overcome the hurdles they encounter financing their growth. It's why we bring renowned business leaders and experts to share their wisdom in our TSB Speaker Series. And it's why we founded TSB Academy, which provides business owners the high-level professional instruction that can help them take their careers and organizations to a higher plane. We're a bank founded by entrepreneurs and dedicated to serving them. Valuing people who seek to learn and improve is one of our core values, and one of the main reasons our bank exists.

*"We have really taken steps to streamline the SBA loan process to make it easier for small businesses to get the loans they need. It's gratifying to be able to help them grow."*

**Chris Jones, Executive Vice President**  
Chief Lending Officer

# GROWTH

## Then and now: Performance

Below is a summary of Texas Security Bankshares, Inc.'s (TSB) financial highlights and performance ratios since 2015. Pages 7 through 10 present TSB's comparative financial statements for the years ended December 31, 2018 and 2017. Pages 11 and 12 include additional financial trends and analysis. The comparative financial statements are presented in our annual audited financial statements. Complete audited financial statements, including the independent auditors' report and the required notes to the consolidated financial statements, may be requested at any time from me.

Our auditors have expressed an unmodified opinion on our consolidated financial statements for both 2018 and 2017. This means that the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Texas Security Bankshares, Inc. and Subsidiary and the results of their consolidated operations and cash flows for these years.



**Drew Keith**  
Executive Vice President, Chief Financial Officer, Chief Operating Officer

(in whole dollars, except per share data)	2015	2016	2017	2018
<b>OPERATING RESULTS</b>				
Net interest income	\$ 10,471,089	\$ 12,079,792	\$ 14,480,571	\$ 16,910,728
Provision for loan losses	423,571	442,401	877,297	4,010,000
Non-interest income	1,686,515	2,036,253	1,890,455	1,939,885
Non-interest expense	7,722,303	8,304,464	9,030,037	9,952,575
Earnings before provision for income tax expense	4,011,730	5,369,180	6,463,692	4,888,038
Income tax expense	1,328,774	1,790,620	2,711,339	1,034,704
Net income	\$ 2,682,956	\$ 3,578,560	\$ 3,752,353	\$ 3,853,334
<b>AT YEAR END</b>				
Total assets	\$303,592,746	\$328,210,170	\$412,347,142	\$476,323,586
Federal funds sold	–	3,000,000	5,500,000	10,000,000
Investments in securities and interest bearing deposits	45,588,072	33,908,952	62,328,610	66,102,716
Loans, net of allowance	247,879,852	281,428,761	333,416,464	388,458,693
Deposits	270,604,844	292,176,471	352,616,100	412,580,832
Stockholders' equity	27,635,446	31,155,258	45,398,647	50,983,982
Common shares outstanding (net of treasury)	2,412,168	2,532,642	3,035,668	3,216,874
<b>OTHER FINANCIAL DATA</b>				
Return on average assets	.96%	1.12%	.97%	.80%
Return on average equity	10.22%	12.04%	8.50%	7.79%
Loans to deposits	92%	97%	95%	95%
Allowance for loan losses to loans	1.04%	1.07%	1.04%	1.00%
Net charge offs to loans	0.02%	0.00%	0.12%	0.91%
<b>PER SHARE DATA</b>				
Net income (basic)	\$ 1.14	\$ 1.45	\$ 1.32	\$ 1.21
Book value	\$ 11.46	\$ 12.30	\$ 15.28	\$ 15.86

## Texas Security Bankshares, Inc. and Subsidiary Consolidated Balance Sheets for the Years Ended December 31, 2018 and 2017

	2018	2017
<b>ASSETS</b>		
Cash and cash equivalents	\$ 1,974,215	\$ 2,201,571
Federal funds sold	10,000,000	5,500,000
Interest bearing deposits in other banks	30,366,297	41,066,713
Total cash and cash equivalents	42,340,512	48,768,284
Time deposits in other banks	749,000	1,246,000
Securities available for sale	34,987,419	20,015,897
Loans held for sale	1,186,500	496,900
Loans, net	387,272,193	332,919,564
Bank premises and equipment, net	5,340,733	5,406,400
Accrued interest receivable	1,188,463	1,137,234
Servicing asset	356,349	360,469
Other assets	2,902,417	1,996,394
<b>Total assets</b>	<b>\$ 476,323,586</b>	<b>\$ 412,347,142</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Deposits		
Non-interest bearing	\$ 114,901,470	\$ 102,301,419
Interest bearing	297,679,362	250,314,681
Total deposits	412,580,832	352,616,100
Other borrowings	10,725,000	12,025,000
Accrued interest payable	831,433	533,124
Other liabilities	1,202,339	1,774,271
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$5 par value; 5,000,000 shares authorized, 3,604,474 and 3,377,618 shares issued, respectively; 3,216,874 and 3,035,668 outstanding, respectively	18,022,370	16,888,090
Additional paid-in capital	23,809,591	21,988,181
Stock issued with notes receivable	(1,985,470)	(2,058,670)
Retained earnings	17,116,313	13,262,979
Accumulated other comprehensive loss	(131,065)	(66,726)
Treasury stock, at cost, 387,600 shares and 341,950 shares, respectively	(5,847,757)	(4,615,207)
Total stockholders' equity	50,983,982	45,398,647
<b>Total liabilities and stockholders' equity</b>	<b>\$ 476,323,586</b>	<b>\$ 412,347,142</b>

# DILIGENCE

Texas Security Bankshares, Inc. and Subsidiary

## Consolidated Statements of Income for the Years Ended December 31, 2018 and 2017

	2018	2017
<b>INTEREST INCOME</b>		
Interest and fees on loans	\$ 18,801,212	\$ 15,713,136
Interest on investment securities	540,396	452,214
Interest on securities purchased under agreements to resell	–	13,438
Interest on federal funds sold	110,428	49,748
Interest on other accounts	1,024,882	372,154
<b>Total interest income</b>	<b>20,476,918</b>	<b>16,600,690</b>
<b>INTEREST EXPENSE</b>		
Interest and fees on deposit accounts	3,009,775	1,614,836
Interest on other borrowings	556,415	505,283
<b>Total interest expense</b>	<b>3,566,190</b>	<b>2,120,119</b>
<b>Net interest income</b>	<b>16,910,728</b>	<b>14,480,571</b>
Provision for loan losses	4,010,000	877,297
<b>Net interest income after provision</b>	<b>12,900,728</b>	<b>13,603,274</b>
<b>NON-INTEREST INCOME</b>		
Service charges on deposit accounts	871,923	686,812
Gain on sales of loans held for sale	514,517	633,268
Gain on sales of SBA loans	303,913	267,109
Net loss on sales of investment securities	(513)	(209)
Other	250,045	303,475
<b>Total non-interest income</b>	<b>1,939,885</b>	<b>1,890,455</b>
<b>NON-INTEREST EXPENSE</b>		
Salaries and employee benefits	6,036,760	5,707,097
Occupancy of bank premises	764,429	673,828
Professional fees	517,760	381,594
Advertising and promotional	231,465	177,044
Data processing and IT management	751,857	750,576
Internet banking	225,433	230,352
Regulatory assessments	190,088	171,012
Software costs	225,559	219,057
Other	1,009,224	719,477
<b>Total non-interest expense</b>	<b>9,952,575</b>	<b>9,030,037</b>
<b>Net income before income tax expense</b>	<b>4,888,038</b>	<b>6,463,692</b>
<b>Income tax expense</b>	<b>1,034,704</b>	<b>2,711,339</b>
<b>Net income</b>	<b>\$ 3,853,334</b>	<b>\$ 3,752,353</b>
<b>Basic earnings per share</b>	<b>\$ 1.21</b>	<b>\$ 1.32</b>
<b>Diluted earnings per share</b>	<b>\$ 1.18</b>	<b>\$ 1.23</b>

Texas Security Bankshares, Inc. and Subsidiary

## Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2018 and 2017

	2018	2017
<b>Net income</b>	<b>\$ 3,853,334</b>	<b>\$ 3,752,353</b>
<b>Other comprehensive income (loss):</b>		
Net unrealized holding losses on available for sale securities during the period	(81,953)	(27,356)
Reclassification adjustment for net realized losses on available for sale securities included in net income	513	209
Other comprehensive loss, before income tax benefit	(81,440)	(27,147)
Income tax benefit	17,101	9,230
Other comprehensive loss, net of income tax benefit	(64,339)	(17,917)
<b>Total comprehensive income</b>	<b>\$ 3,788,995</b>	<b>\$ 3,734,436</b>

Texas Security Bankshares, Inc. and Subsidiary

## Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2018 and 2017

	Common Stock	Additional Paid-In Capital	Stock Issued with Notes Receivable	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
<b>Balance, January 1, 2017</b>	<b>\$14,372,960</b>	<b>\$13,708,888</b>	<b>\$(1,773,200)</b>	<b>\$9,499,646</b>	<b>\$(37,829)</b>	<b>\$(4,615,207)</b>	<b>\$31,155,258</b>
Sale of common stock, 503,026 shares	2,515,130	8,224,078	(285,470)	–	–	–	10,453,738
Net income	–	–	–	3,752,353	–	–	3,752,353
Stock-based compensation	–	55,215	–	–	–	–	55,215
Reclassification of stranded tax effects due to change in tax rate	–	–	–	10,980	(10,980)	–	–
Other comprehensive loss	–	–	–	–	(17,917)	–	(17,917)
<b>Balance, December 31, 2017</b>	<b>16,888,090</b>	<b>21,988,181</b>	<b>(2,058,670)</b>	<b>13,262,979</b>	<b>(66,726)</b>	<b>(4,615,207)</b>	<b>45,398,647</b>
Sale of common stock, 226,856 shares	1,134,280	1,773,058	(306,460)	–	–	–	2,600,878
Payments received on notes receivable	–	–	379,660	–	–	–	379,660
Purchase of treasury stock, 45,650 shares	–	–	–	–	–	(1,232,550)	(1,232,550)
Net income	–	–	–	3,853,334	–	–	3,853,334
Stock-based compensation	–	48,352	–	–	–	–	48,352
Other comprehensive loss	–	–	–	–	(64,339)	–	(64,339)
<b>Balance, December 31, 2018</b>	<b>\$18,022,370</b>	<b>\$23,809,591</b>	<b>\$(1,985,470)</b>	<b>\$17,116,313</b>	<b>\$(131,065)</b>	<b>\$(5,847,757)</b>	<b>\$50,983,982</b>

# INTEGRITY

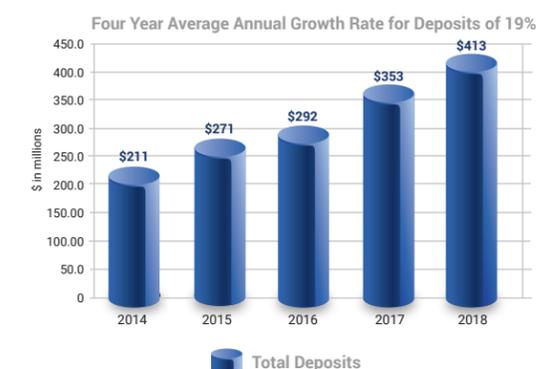
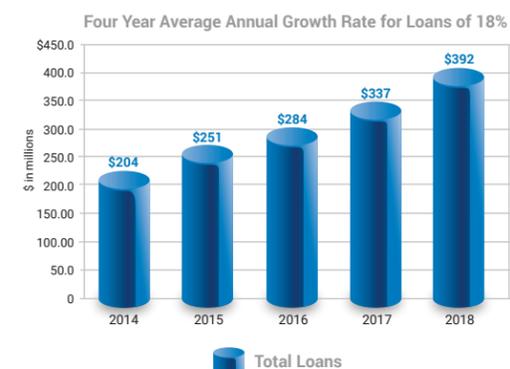
Texas Security Bankshares, Inc. and Subsidiary  
**Consolidated Statements of Cash Flows for the Years Ended December 31, 2018 and 2017**

	2018	2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 3,853,334	\$ 3,752,353
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, net	502,247	554,305
Provision for loan losses	4,010,000	877,297
Net loss on sales of securities	513	209
Gain on sales of SBA loans	(303,913)	(267,109)
Gain on sales of loans held for sale	(514,517)	(633,268)
Proceeds from sales of loans held for sale	26,909,792	26,171,974
Net originations of loans held for sale	(27,084,875)	(25,271,506)
Stock-based compensation	48,352	55,215
Increase in accrued interest and other assets	(940,151)	(672,121)
(Decrease) increase in accrued expenses and other liabilities	(273,623)	660,530
<b>Net cash provided by operating activities</b>	<b>6,207,159</b>	<b>5,227,879</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Activity in available for sale securities:		
Maturities, calls, sales and principal paydowns received	304,494,430	302,231,475
Purchases	(319,655,468)	(299,984,664)
Net originations of loans	(58,158,888)	(52,999,075)
Additions to bank premises and equipment	(224,725)	(111,051)
Net decrease in securities purchased under agreements to resell	-	473,294
Net (increase) decrease in time deposits in other banks	497,000	(996,000)
<b>Net cash used in investing activities</b>	<b>(73,047,651)</b>	<b>(51,386,021)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net change in deposits	59,964,732	60,439,629
Repayments of other borrowings	(16,300,000)	(4,206,576)
Proceeds from other borrowings	15,000,000	13,000,000
Proceeds from sale of common stock	2,600,878	10,453,738
Payments received on notes receivable	379,660	-
Purchase of treasury stock	(1,232,550)	-
<b>Net cash provided by financing activities</b>	<b>60,412,720</b>	<b>79,686,791</b>
<b>Net (decrease) increase in cash and cash equivalents</b>	<b>(6,427,772)</b>	<b>33,528,649</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>48,768,284</b>	<b>15,239,635</b>
<b>Cash and cash equivalents at end of year</b>	<b>\$ 42,340,512</b>	<b>\$ 48,768,284</b>
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid for interest	\$ 3,267,881	\$ 1,966,791
Cash paid for income taxes	\$ 1,457,000	\$ 2,659,224

## Financial Trends

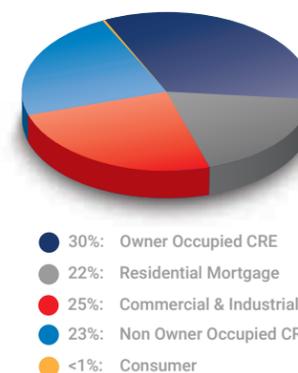
Texas Security Bankshares, Inc. and Subsidiary

### Balance Sheet Growth

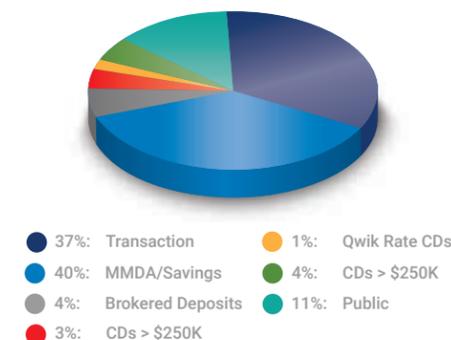


### Balance Sheet Makeup

December 2018 Loan Portfolio

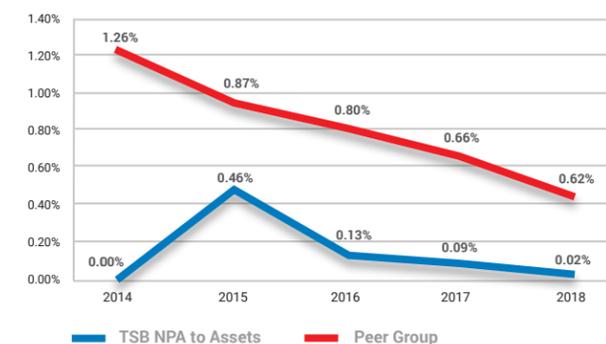


December 2018 Deposit Mix



### Credit Quality

No significant non-performing assets despite substantial growth

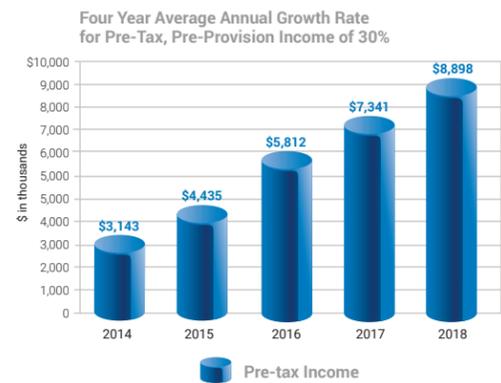


# HONESTY

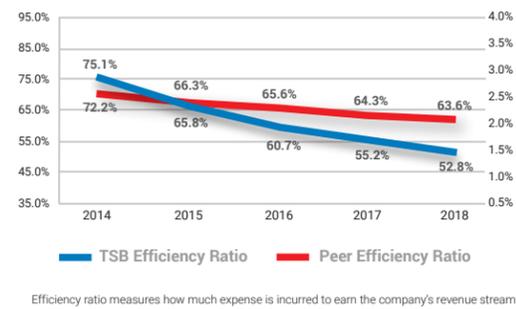
## Financial Trends

Texas Security Bankshares, Inc. and Subsidiary

### Pre-Tax Pre-Provision Income



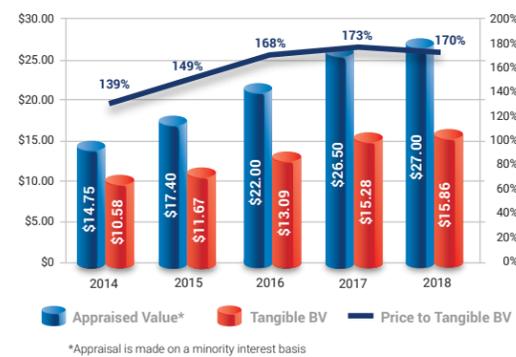
### Efficiency Measurements



### EPS Growth



### Enhancing Shareholder Value



*“So that the record of history is absolutely crystal clear. That there is no alternative way, so far discovered, of improving the lot of the ordinary people that can hold a candle to the productive activities that are unleashed by a free enterprise system.”*

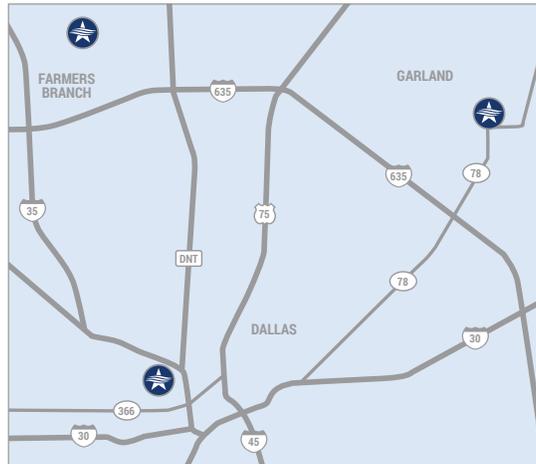
Milton Friedman



# TEXAS SECURITY

BANK

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