



TEXAS SECURITY

BANK



ELEVATING THE CHAMPIONS OF FREE
ENTERPRISE

2019 ANNUAL REPORT
TEXAS SECURITY BANKSHARES, INC.

STEPPING UP

Even in challenging times, we stay on course. We reach deep, and we find new resolve. Pacing ourselves, we reaffirm that it is not a race but a marathon. We continue moving forward, knowing that throughout our history the fuel that has always driven American progress is our determination to overcome adversity with endurance. To overcome hurdles with ingenuity. We are carrying the banner of Free Enterprise. And we continue going the distance to elevate a team of champions.



Dear fellow shareholders,

Unprecedented! The executives of Texas Security Bankshares and its subsidiary Texas Security Bank (the “Company”) each have three decades of banking and operating experience, yet we have never endured an economic hard stop of the proportion created by the COVID-19 global pandemic. Our Bank was fundamentally prepared. Over the past three years, the Bank executed strategic moves that have proven to be of great value.



In 2019, the Bank had a year of recovery and progress. We returned to a normal level of earnings of \$2.14 per share, up from \$1.21 in 2018. We produced solid core asset growth and maintained excellent credit quality. Net income of \$6.9 million represented a \$3.0 million increase over 2018. While the Bank’s loan growth appeared low, the true loan growth was masked by a \$31 million bulk sale of residential mortgage loans. This bulk loan sale was part of a strategic repositioning of our balance sheet to enable growth in more valuable core commercial banking relationships. These core relationships provide low-cost deposits and higher, broader utilization of other products and services.

Credit quality has remained strong. The Bank had no charge-offs in 2019, zero non-performing loans at year-end and reserves of 1.27% of total loans and leases. Core earnings (pre-tax, pre-provision earnings) increased to \$9.8 million, a 10% increase over 2018. Return on average assets (ROA) of 1.22% and return on average equity (ROE) of 12.7% represented significant improvement over 2018.

Total assets grew to \$564 million, up from \$476 million at year-end 2018. A portion of this growth reflects our implementation of a capital optimization strategy that utilizes capital above regulatory requirements to generate additional income for an interim period. The growth of our primary asset base of high-quality commercial and industrial loans and owner-occupied commercial real estate loans as well as growth in our funding base of low-cost core deposits will replace the components of this capital optimization strategy. In early 2020, the Bank reached \$180 million of securities and a like amount of non-core funding to support this strategy.

To prepare for the future, the Bank executed a secondary offering in 2017 that yielded \$13 million of additional capital for growth and strengthening of the Bank’s balance sheet. In August 2019, the Company placed \$14.5 million of subordinated notes, retiring the Bank’s senior secured amortizing debt while retaining \$4.6 million for general corporate purposes. This gave us a margin of safety in our balance sheet while providing flexibility.

Because of our preparation, the Bank could double its reserves immediately, if necessary, by utilizing the retained cash. Furthermore, the repositioning of the Bank’s securities portfolio, including the capital optimization strategy securities, is intended to provide the Company stable earnings in a declining rate environment. The culmination of our 2017 secondary offering, subordinated debt placement and strategic investment in securities is proving to be very beneficial.

Even though we are in the most challenging and dynamic economic environment I have experienced in my 32-year banking career, the Bank is well-positioned, stable and strong. We are focused on the opportunities that have arisen thus far in 2020 and those that will undoubtedly arise over the course of this year. We are here to enhance the lives of *all* our stakeholders. Finally, as we continue to Elevate the Champions of Free Enterprise, we expect to thrive and prosper while we navigate these extraordinary times.

Craig Scheef
Chairman, President, Founder, Chief Executive Officer



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.

Our Leadership

Leadership Team

Craig Scheef
Chairman, President, Founder
Chief Executive Officer

Drew Keith
Executive Vice President, Founder
Chief Financial Officer

Ben Parkey
Senior Vice President
Turtle Creek Market President

Libby Smith
Senior Vice President
Mortgage Lending

Chris Jones
Executive Vice President, Founder
Chief Lending Officer

Shon C. Cass
Executive Vice President, Founder
Northeast Region Market President

C.D. Heinen
Senior Vice President
Metrocrest Market President

Board of Directors

Chris Jones
Texas Security Bank

Drew Keith
Texas Security Bank

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

Chris Kirkpatrick
Partner, Corporate Section, Wick Phillips Gould & Martin, LLP

Cortney Liddiard
CEO, Ball Ventures, LLC

Scott Miller
Principal, Miller Global Investments, LLC

LeAnn Nabors
CFO, The Wright Group

Gina Norris
SVP Partner Relations, Matthews Southwest

Langhorne Reid
President, Arcady Capital, Inc.

Craig Scheef
Texas Security Bank

Joe Shockley
Retired, EVP & CFO, Southwest Bancorp, Inc.

Mike Thomas
President, Life Sciences & Health Technologies for NTT Data, Inc.

TEACHING SUCCESS

The smartest business owners are those who never stop learning. They're also the ones most likely to succeed. At Texas Security Bank, our business model is built on our commitment to educating entrepreneurs. We know that elevating the knowledge of our business-owner customers is the most authentic way to maintain the success of our bank. It's this unique focus on business education that sets our bank apart – and sets our customers up for prosperity.

Business Speaker Series: Elevating our champions through education

Our Business Speaker Series and BOLD Speaker Series 2.0 are monthly continuing education forums. The presentations are led by executive professionals designed to enhance business owners' knowledge in critical business disciplines so that they may maximize the achievements of their enterprises. The BOLD Speaker Series 2.0 is an addition to the Business Speaker Series this year and held in conjunction with the Garland Chamber of Commerce.



With the coronavirus (COVID-19) outbreak, we recognize that some of our business owners need us now more than ever. As a result, we've adapted our format to Zoom video meetings, which are focused on topics related to COVID-19. Join us by Zoom or in person. Your success is our greatest inspiration.

2019 Business Speaker Series

Addressing Unique Security & Risk Management Concerns in Your Business *by Jeff McKissack*
Right People, Right Seats *by Jason Williford*
#NotUs in a #MeToo World *by Terri Swain*
Hope is not a Strategy *by Bud Moore*
Digitally Enhance Your Brand *by Corbett Guest*
Entrepreneurial Operating System *by Jeff Whittle*
The Role of Accounting in Building Enterprise Value *by Chris McKee*
Ransomware *by Terry Oehring/Derek Wright*
Hiring and Retaining Top Talent *by Jamie Crosbie*

2020 Business Speaker Series

Planning with Optimism *by Taylor St. Germain*
Creative Compensation for Employees *by Loic LeMener*
B2B Branding: Be Better Than Your Industry *by David Richardson*
Employment Law 101 *by Alana Ackels & Mark Shoffner*
Building a Winning Sales Strategy *by Matthew Smith*
Creating a Legacy Mindset *by Rick Sapio*
How to Sell your Business *by Jared Behnke*

BOLD Speaker Series 2.0

Planning with Optimism *by Taylor St. Germain*
Business Taxes: Tips, Changes & Strategy *by Frank Burns*
How to Compete for Good Talent *by Meredith Spurier*
Capturing your Thought Leadership *by Tim Nichols*

Texas Security Bank is the only bank in Texas that invests in business education for owner-managed businesses. Our focus on continuing education is not only unique but needed. In an era when little differentiation among banks exists, we Elevate the Champions of Free Enterprise.



TSB Academy: Our best investment is you

The only one of its kind in Texas, our TSB Academy is an intensive course that allows you to take your business knowledge to a higher level without interrupting the day-to-day management of your company. The course is designed to develop overall leadership as well as provide you with the foundational, strategic and functional tools that allow you to grow your business in today's ever-changing business environment. Covering topics from accounting to capital sources and from cyber security to brand differentiation, the curriculum includes 50 hours of instruction over two semesters.

Interested in being considered for admission to the September 2020 class? Please contact Pamela McQuade at Pamela.McQuade@texassecuritybank.com, and submit your completed application by September 1, 2020.

Cristo Rey Dallas College Prep: Paying it forward

Texas Security Bank is not only invested in educating our business-owner customers but also committed to helping students succeed in college and life. We are donating the tuition from the TSB Academy to Cristo Rey Dallas College Prep to fund student tuition. Cristo Rey is a college prep school for kids who would not otherwise be able to attend college. Some graduates go on to become first-generation college students.

In addition to college preparation, Cristo Rey prepares high school kids for the job market as well. The students literally go to work on scheduled days at Cristo Rey supporting companies and then go to class on their days off. By the time the students graduate, they already have four years of work experience on their resumé.

As a proud supporter of Cristo Rey, what does this mean for Texas Security Bank? Later this year, we plan to have four new faces in our IT Department who will rotate days at our Farmers Branch location. Bottom line? We make a donation. Students receive on-the-job training in our office. It's a win-win for all. To learn more about Cristo Rey, visit www.cristoreydallas.org

PROVEN TRUST

Then and now: Performance

Below is a summary of Texas Security Bankshares, Inc.'s (TSB) financial highlights and performance ratios for 2015 through 2019. Pages 7-10 present TSB's comparative consolidated financial statements for the years ended December 31, 2019 and 2018. These reports are presented in our annual audited financial statements. You may request complete audited financial statements, including the independent auditors' report and the required notes to the consolidated financial statements, at any time from me.

Our auditors have expressed an unmodified opinion on our consolidated financial statements for both 2019 and 2018. 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	2019
OPERATING RESULTS					
Net interest income	\$ 10,471,089	\$ 12,079,792	\$ 14,480,571	\$ 16,910,728	\$ 18,642,057
Provision for loan loss	423,571	442,401	877,297	4,010,000	900,000
Non-interest income	1,436,636	1,870,980	1,890,664	1,940,398	2,766,074
Net realized gain (loss) on sales of securities	249,879	165,273	(209)	(513)	111,446
Non-interest expense	7,722,303	8,304,464	9,030,037	9,952,575	11,750,547
Earnings before provision for income tax expense	4,011,730	5,369,180	6,463,692	4,888,038	8,869,030
Income tax expense	1,328,774	1,790,620	2,711,339	1,034,704	1,986,692
Net income	\$ 2,682,956	\$ 3,578,560	\$ 3,752,353	\$ 3,853,334	\$ 6,882,338
AT YEAR END					
Total assets	\$303,592,746	\$328,210,170	\$412,347,142	\$476,323,586	\$563,612,766
Federal funds sold	–	3,000,000	5,500,000	10,000,000	–
Investments in securities & interest bearing deposits	45,588,072	33,908,952	62,328,610	66,102,716	146,794,120
Loans, net of allowance	247,879,852	281,428,761	333,416,464	388,458,693	403,165,079
Deposits	270,604,844	292,176,471	352,616,100	412,580,832	488,076,434
Stockholders' equity	27,635,446	31,155,258	45,398,647	50,983,982	57,055,607
Common shares outstanding (net of treasury)	2,412,168	2,532,642	3,035,668	3,216,874	3,194,264
OTHER FINANCIAL DATA					
Return on average assets	.96%	1.12%	.97%	.80%	1.22%
Return on average equity	10.22%	12.04%	8.50%	7.79%	12.70%
Loans to deposits	92%	97%	95%	95%	83%
Allowance for loan losses to loans	1.04%	1.07%	1.04%	1.00%	1.27%
Net charge offs to loans	0.02%	0.00%	0.12%	0.91%	0.00%
PER SHARE DATA					
Net income (basic)	\$ 1.14	\$ 1.45	\$ 1.32	\$ 1.21	\$ 2.14
Book Value (BV)	\$ 11.46	\$ 12.30	\$ 15.28	\$ 15.86	\$ 17.82

Texas Security Bankshares, Inc. and Subsidiary Consolidated Balance Sheets for the Years Ended December 31, 2019 and 2018

	2019	2018
ASSETS		
Cash and cash equivalents	\$ 1,927,421	\$ 1,974,215
Federal funds sold	–	10,000,000
Interest bearing deposits in other banks	61,301,996	30,366,297
Total cash and cash equivalents	63,229,417	42,340,512
Time deposits in other banks	–	749,000
Securities available for sale, at fair value	85,492,124	34,987,419
Loans held for sale	551,800	1,186,500
Loans, net	402,613,279	387,272,193
Bank premises and equipment, net	5,336,572	5,340,733
Accrued interest receivable	1,346,680	1,188,463
Servicing asset	303,673	356,349
Other assets	4,739,221	2,902,417
Total assets	\$ 563,612,766	\$ 476,323,586
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	\$ 122,011,650	\$ 114,901,470
Interest bearing	366,064,784	297,679,362
Total deposits	488,076,434	412,580,832
Other borrowings	14,500,000	10,725,000
Accrued interest payable	1,012,842	831,433
Other liabilities	2,967,883	1,202,339
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$5 par value; 5,000,000 shares authorized, 3,636,778 and 3,604,474 shares issued, respectively; 3,194,264 and 3,216,874 outstanding, respectively	18,183,890	18,022,370
Additional paid-in capital	24,187,077	23,809,591
Stock issued with notes receivable	(1,972,450)	(1,985,470)
Retained earnings	23,998,651	17,116,313
Accumulated other comprehensive loss	(175,868)	(131,065)
Treasury stock, at cost, 442,514 shares and 387,600 shares, respectively	(7,165,693)	(5,847,757)
Total stockholders' equity	57,055,607	50,983,982
Total liabilities and stockholders' equity	\$ 563,612,766	\$ 476,323,586

OPERATIONAL DURABILITY

Texas Security Bankshares, Inc. and Subsidiary
Consolidated Statements of Income for the Years Ended December 31, 2019 and 2018

	2019	2018
INTEREST INCOME		
Interest and fees on loans	\$ 21,798,520	\$ 18,801,212
Interest on investment securities	810,219	540,396
Interest on federal funds sold	134,391	110,428
Interest on other accounts	898,026	1,024,882
Total interest income	23,641,156	20,476,918
INTEREST EXPENSE		
Interest and fees on deposit accounts	4,279,507	3,009,775
Interest on other borrowings	719,592	556,415
Total interest expense	4,999,099	3,566,190
Net interest income	18,642,057	16,910,728
Provision for loan losses	900,000	4,010,000
Net interest income after provision	17,742,057	12,900,728
NON-INTEREST INCOME		
Service charges on deposit accounts	845,350	871,923
Gain on sales of mortgage loans	1,465,785	514,517
Gain on sales of SBA loans	215,183	303,913
Net gain (loss) on sales of investment securities	111,446	(513)
Other	239,756	250,045
Total non-interest income	2,877,520	1,939,885
NON-INTEREST EXPENSE		
Salaries and employee benefits	7,571,472	6,036,760
Occupancy of bank premises	801,219	764,429
Professional fees	599,228	517,760
Advertising and promotional	163,529	231,465
Data processing and IT management	958,975	751,857
Internet banking	189,452	225,433
Regulatory assessments	165,002	190,088
Software costs	237,033	225,559
Other	1,064,637	1,009,224
Total non-interest expense	11,750,547	9,952,575
Net income before income tax expense	8,869,030	4,888,038
Income tax expense	1,986,692	1,034,704
Net income	\$ 6,882,338	\$ 3,853,334
Basic earnings per share	\$ 2.14	\$ 1.21
Diluted earnings per share	\$ 2.09	\$ 1.18

Texas Security Bankshares, Inc. and Subsidiary
Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2019 and 2018

	2019	2018
Net income	\$ 6,882,338	\$ 3,853,334
Other comprehensive income (loss):		
Net unrealized holding gains (losses) on available for sale securities during the period	54,731	(81,953)
Reclassification adjustment for net realized (gains) losses on available for sale securities included in net income	(111,446)	513
Other comprehensive loss, before income tax benefit	(56,715)	(81,440)
Income tax benefit	11,912	17,101
Other comprehensive loss, net of income tax benefit	(44,803)	(64,339)
Total comprehensive income	\$ 6,837,535	\$ 3,788,995

Texas Security Bankshares, Inc. and Subsidiary
Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2019 and 2018

	Common Stock	Additional Paid-In Capital	Stock Issued with Notes Receivable	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Balance, January 1, 2018	\$16,888,090	\$21,988,181	\$(2,058,670)	\$13,262,979	\$ (66,726)	\$(4,615,207)	\$45,398,647
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)
Balance, December 31, 2018	18,022,370	23,809,591	(1,985,470)	17,116,313	(131,065)	(5,847,757)	50,983,982
Sale of common stock, 32,304 shares	161,520	244,483	(104,800)	—	—	—	301,203
Payments received on notes receivable	—	—	117,820	—	—	—	117,820
Purchase of treasury stock, 54,914 shares	—	—	—	—	—	(1,317,936)	(1,317,936)
Net income	—	—	—	6,882,338	—	—	6,882,338
Stock-based compensation	—	133,003	—	—	—	—	133,003
Other comprehensive loss	—	—	—	—	(44,803)	—	(44,803)
Balance, December 31, 2019	\$18,183,890	\$24,187,077	\$(1,972,450)	\$23,998,651	\$ (175,868)	\$(7,165,693)	\$57,055,607

ENDURING

SERVICE

Texas Security Bankshares, Inc. and Subsidiary
Consolidated Statements of Cash Flows for the Years Ended December 31, 2019 and 2018

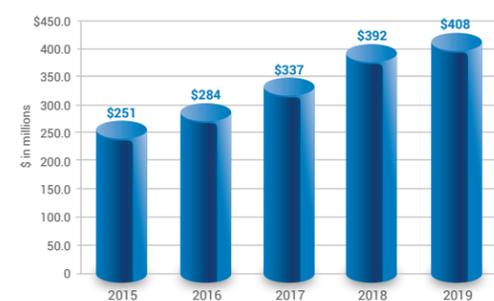
	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 6,882,338	\$ 3,853,334
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, net	396,302	502,247
Provision for loan losses	900,000	4,010,000
Net (gain) loss on sales of securities	(111,446)	513
Gain on sales of SBA loans	(215,183)	(303,913)
Gain on sales of loans held for sale	(817,159)	(514,517)
Proceeds from sales of loans held for sale	41,058,269	26,909,792
Net originations of loans held for sale	(39,606,410)	(27,084,875)
Gain on bulk sales of mortgage loans	(648,626)	–
Stock-based compensation	133,003	48,352
Increase in accrued interest and other assets	(1,983,109)	(940,151)
Increase (decrease) in accrued expenses and other liabilities	1,946,953	(273,623)
Net cash provided by operating activities	7,934,932	6,207,159
CASH FLOWS FROM INVESTING ACTIVITIES		
Activity in available for sale securities:		
Maturities, calls, sales and principal paydowns received	627,942,933	304,494,430
Purchases	(678,376,120)	(319,655,468)
Net originations of loans	(46,523,854)	(58,158,888)
Proceeds from bulk sales of mortgage loans	31,071,126	–
Additions to bank premises and equipment	(280,801)	(224,725)
Net decrease in time deposits in other banks	749,000	497,000
Net cash used in investing activities	(65,417,716)	(73,047,651)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net change in deposits	75,495,602	59,964,732
Repayments of other borrowings	(471,825,000)	(16,300,000)
Proceeds from other borrowings	475,600,000	15,000,000
Proceeds from sale of common stock	301,203	2,600,878
Payments received on notes receivable	117,820	379,660
Purchase of treasury stock	(1,317,936)	(1,232,550)
Net cash provided by financing activities	78,371,689	60,412,720
Net increase (decrease) in cash and cash equivalents	20,888,905	(6,427,772)
Cash and cash equivalents at beginning of year	42,340,512	48,768,284
Cash and cash equivalents at end of year	\$ 63,229,417	\$ 42,340,512
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 4,817,690	\$ 3,267,881
Cash paid for income taxes	\$ 425,000	\$ 1,457,000
Noncash transaction:		
Set up of ROU asset and lease liability upon adoption of ASC 842	\$ 545,290	–

Financial Trends

Texas Security Bankshares, Inc. and Subsidiary

Balance Sheet Growth

Four Year Average Annual Growth Rate for Loans of 13%*



*2019 activity includes bulk sales of mortgage loans of \$31 million, which, if excluded, would result in an annual growth rate of 15%

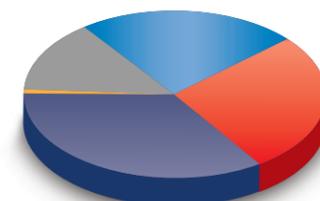
Four Year Average Annual Growth Rate for Deposits of 16%**



**2019 activity includes brokered deposits of \$75 million, some of which are related to the capital optimization strategy, which, if excluded in total, would result in an annual growth rate of 11%

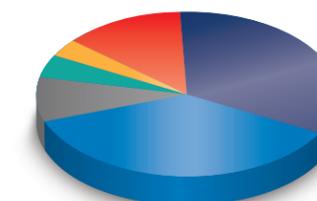
Balance Sheet Makeup

December 31, 2019 Loan Portfolio



- 34.6%: Commercial Real Estate - Owner Occupied
- 27.3%: Commercial Real Estate
- 23.7%: Commercial & Industrial
- 14.2%: Residential Mortgage
- <1%: Consumer

December 31, 2019 Deposit Mix

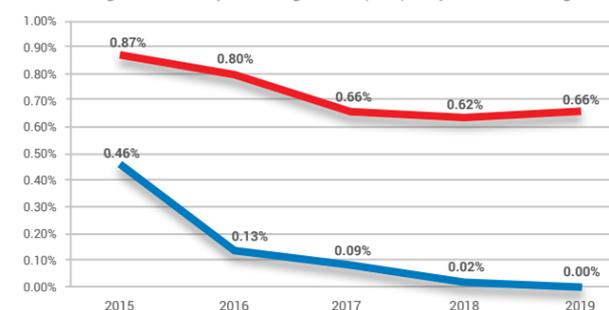


- 38.8%: MMDA/Savings
- 32.4%: Transaction
- 15.4%: Brokered Deposits
- 6.9%: CDs > \$250K
- 3.9%: Public Funds
- 2.6%: CDs < \$250K

Of the \$75 million in brokered deposits, \$60 million or 12.3% of deposits, were part of the capital optimization strategy executed in 2019

Credit Quality

No significant Non-performing Assets (NPA) despite substantial growth

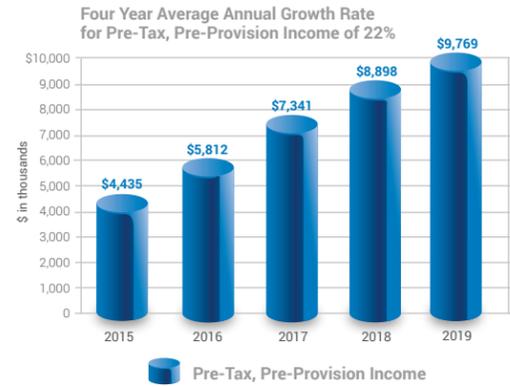


STRONGER TOGETHER

Financial Trends

Texas Security Bankshares, Inc. and Subsidiary

Pre-Tax, Pre-Provision Income



Efficiency Measurements



Efficiency ratio measures how much expense is incurred to earn the company's revenue stream.

EPS Growth

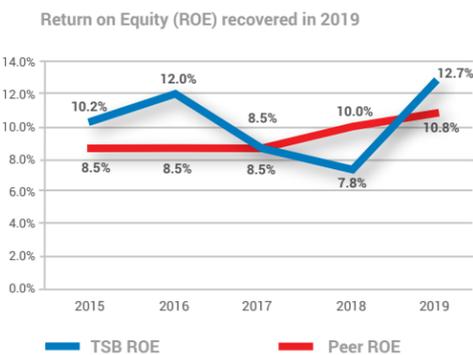


Enhancing Shareholder Value



*Appraisal is made on a minority interest basis

Profitability Metrics



2017 includes a \$536,820 increase in Federal Income Tax Expense due to the 2017 Tax Act
2018 includes a single loan charge off of \$3,612,500

“America was not built on fear. America was built on courage, on imagination and an unbeatable determination to do the job at hand.”

– former President Harry S. Truman



TEXAS SECURITY

BANK

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